TITLE OF THE DISSERTATION

"COMPARATIVE STUDY OF CREDIT RATING PROCESS OF CRISIL AND ICRA"

Review of literature

Pogue and Soldofsky (1969) tried to assess the importance of „Rater’s Judgment‟ in the determination of bond ratings as this judgment was based on much more information than contained in readily available financial statistics by taking data set of industrial, utility and railroad binds rated by Moody‟s from 1961 through 1966. The authors found that the probability of getting higher rating was directly related to firm’s size and profitability and it was inversely related to leverage and earning instability of the issuing firm. The authors revealed that although the rater‟s judgment (which is based on much more information than that contained in available statistics) affected the bond ratings, yet the bond ratings could be better explained by the available financial and operating statistics.

Duggal (1992) tried to find out the relevance of credit rating in the Indian context and the extent of awareness about the concept of credit rating and the rating agencies in India. She evaluated the working of rating agencies in the light of experience of the rated companies and tried to foresee the future prospects of credit rating in India. The author suggested that the credit rating agencies need to create awareness about their existence and importance. So, they should give publicity to their operations. Further, there is a need for more credit rating agencies in India and a few of them should be from private sector. All the agencies should have a proper co-ordination with one another and they should improve quality of their services. The author also suggested that the high fees charged by the rating agencies should be reduced in order to make their services more efficient

Shankar et al. (1992) tried to evaluate the operations of CRISIL which include the methodology of rating, rating process, rating symbols, etc. The authors found that there were certain shortcomings in the working of CRISIL. First of all, ratings were not frequently revised by the agency as done in other countries. The companies not scoring well did not reveal their ratings because neither it was mandatory on them to reveal their ratings nor CRISIL had any and future projections of the organization. So, the authors suggested that each company should get itself rated by both CRISIL and ICRA to make their rating really meaningful. Further, these agencies should work independently, and should give professional and impartial assessment of instruments without any fear or favour

Gopal (1995) examined the practices and procedures followed by two Indian credit rating agencies CRISIL and ICRA. He also analyzed the effect of bond rating changes on the security prices. He observed that the basic approach to rate certain instruments was similar for all the rating agencies though they all used different terminology. He also pointed out that the investors did not take into consideration the rating of debt instruments while investing in the 42 equity shares; and the credit rating agencies were not information specialists as the investors might have taken information from other sources also. He suggested that the rating agencies would have to take unsolicited ratings and should publish their opinions in order to make their operations more transparent and useful.

Upadhye (2005), in her study, concentrated on an overview of credit rating system in India. The paper explained the various factors being taken into consideration by rating agencies which include past performance, profit turnover, cash flow and fund flow, nature of competition, etc. and various types of ratings being done by ICRA. The paper also gave details of various Credit Rating Agencies in India like CRISIL, ICRA, CARE, and ONICRA. The author criticized the working of these agencies and suggested that a standardized fee structure and standardized rating grades should be adopted by all rating agencies in order to simplify the procedures.

Research Methodology

Description

A research method is a systematic plan for conducting research. Sociologists draw on a variety of both qualitative and quantitative research methods, including experiments, survey research, participant observation, and secondary data.

Research Design:

Research design is framework of blueprint for conducting the dissertation. It details the procedure necessary for obtaining information needed to structure to solve problem. “A research is the arrangement of condition for collections and analysis of data in a manner that aims to combine relevance to the research purpose with economy is produced.”

The purpose of research is to discover the answer of questions through application of scientific procedure. The aim of research is to find out the truth that has been not been discovered yet. “Research is an art of scientific investigation”

Data Collection

Data collection is the process of gathering and measuring information on targeted variables in an established system, which then enables one to answer relevant questions and evaluate outcomes.

- Secondary Data

  Secondary data refers to data which is collected by someone who is someone other than the user. Common sources of secondary data for social science include censuses, information collected by government departments, organizational records and data that was originally collected for other research purposes.

He expressed his conclusions using letter-rating symbols adopted from the mercantile and credit rating system that had been used by the credit-reporting firms since the late 1800s. Moody had now entered the business of analyzing the stocks and bonds of America’s railroads, and with this endeavor, he became the first to rate public market securities. In 1909, Moody’s Analyses of Railroad Investments described for readers the analytic principles that Moody used to assess a railroad’s operations, management, and finance. The new manual quickly found a place in investors’ hands. In 1913, he expanded his base of analyzed companies, launching his evaluation of industrial companies and utilities. By that time, the "Moody's ratings" had become a factor in the bond market. On July 1, 1914, Moody's Investors Service was incorporated. That same year, Moody began expanding rating coverage to bonds issued by US cities and other municipalities.

Further expansion of the credit rating industry took place in 1916, when the Poor's Publishing Company published its first rating followed by the Standard Statistics Company in 1922, and Fitch Publishing Company in 1924. The Standard Statistics Company merged in 1941 to form Standard and Poor's, which was subsequently taken over by McGraw Hill in 1966. For almost 50 years, since the setting up of Fitch Publishing in 1924, there were no major new entrants in the field of credit rating and then in the 1970s, a number of credit rating agencies commenced operations all over the world. These included the Canadian Bond Rating Service (1972), Thomson Bank watch (1974), Japanese Bond Rating Institute (1975), McCarthy Creasing and Maffei (1975 acquired by Duff and Phelps in 1991), Dominican Bond Rating Service (1997), IBCA Limited (1978), and Duff and Phelps Credit Rating Company (1980). There are credit rating agencies in operation in many other countries such as Malaysia, Philippines, Mexico, Indonesia, Pakistan, Cyprus, Korea, Thailand and Australia.

In India, the Credit Rating and Information Services of India Ltd. (CRISIL) was set up as the first rating agency in 1987, followed by ICRA Ltd. (formerly known as Investment Information and Credit Rating Agency of India Limited) in 1991, and Credit Analysis and Research Ltd. (CARE) in 1994. The ownership pattern of all the three agencies is institutional. Duff and Phelps has tied up with two Indian NBFCs to set up Duff and Phelps Credit Rating India (P) Limited in 1996.

7. Individuals Rating

Rating of individuals is called as individual's credit rating.

8. Structured Obligation Rating

Structured obligations are also debt obligations and are different from debenture or bond or fixed deposit programmers and commercial papers. Structured obligation is generally asset-backed security. Credit rating agencies assessed the risk associated with the transaction with the main trust on cash flows emerging from the asset would be sufficient to meet committed payments, to the investors in worst case scenario.

9. Sovereign Rating

Is a rating of a country, which is being considered whenever a loan is to be extended, or some major investment is envisaged in a country.

CREDIT RATING AGENCY

A credit rating agency (CRA) is a company that assigns credit ratings for issuers of certain types of debt obligations. In most cases, these issuers are companies, cities, non-profit organizations, or national governments issuing debt-like securities that can be traded on a secondary market. A credit rating measures credit worthiness, the ability to pay back a loan, and affects the interest rate applied to loans. (A company that issues credit scores for individual credit-worthiness is generally called a credit bureau or consumer credit reporting agency.)

Interest rates are not the same for everyone, but instead are based on risk-based pricing, a form of price discrimination based on the different expected costs of different borrowers, as set out in their credit rating. There exist more than 100 rating agencies worldwide.

USES OF RATINGS BY CREDIT RATING AGENCIES

Credit ratings are used by investors, issuers, investment banks, broker-dealers, and by governments. For investors, credit rating agencies increase the range of investment alternatives and provide independent, easy-to-use measurements of relative credit risk; this generally increases the efficiency of the market, lowering costs for both borrowers and lenders. This in turn increases the total supply of risk capital in the economy, leading to stronger growth. It also opens the capital markets to categories of borrower who might otherwise be shut out altogether: small governments, startup companies, hospitals and universities.

Legal position of issue of debt instrument is assessed by letter of offer; terms of debenture trust deed, trustees and their responsibilities; system of timely payment of interest and principal; or protection of forgery and fraud. Thus, business covers all relevant aspects as related to business operations of the client company to assess the creditworthiness of the company.

2. Financial Analysis

Under financial analysis, all relevant aspects connected with the business and financial position of the company is assessed in the following four important segments. Firstly the accounting finally is seen as qualifications of auditors; focus on determining extent to which performance is overstated; method of income recognition; depreciation policies and inventory calculations; Under Valued/Over Valuing of assets; or off balance sheet liabilities.

Secondly, the Earning Potential return to long term earning potential under varying conditions is assessed. Key consideration is: Profitability ratios; pretax coverage ratios; earnings on assets/capital employed; source of future earnings; or ability to finance growth internally.

Thirdly, the adequacy of the Cash Flows is appraised in relation to debt and fixed and working capital requirements of the company. Main focus of analysis is on variability of future cash flows; capital spending flexibility; cash flows to fix and working capital requirements; or Working Capital management. Fourthly, the Financial Flexibility is assessed through financial plans in times of stress and their reliability; ability to attract capital; capital spending flexibility; asset redeployment potential; or the debt service schedule.

3. Management Evaluation

The track record of management is evaluated by observing:

- the goals and philosophies;
- strategies and ability to overcome adverse situations;
- judgment of management performance based on past operating and financial results;
- planning and control systems;
- conservatism or aggressiveness with reference to financial risk;
- depths of managerial, talents and succession plans;

CA

Bonds, which are rated CC, represent obligations, which are speculative in some degree. Such issues are often in default or have other marked shortcomings.

C

Bonds, which are rated C, are the lowest rated class of bonds and issues so rated are to be regarded as having extremely poor prospects of ever attaining any real investment standing.

Moody's Commercial Paper Ratings

Promissory notes sold in the open market by large corporations and having an original maturity of nine months or less are known as commercial paper. Moody's assigns those commercial notes it is willing to rate to one of three quality categories:

Prime-1 (or P-l) - Highest quality
Prime-2 (or P-2) - Higher quality
Prime-3 (or P-3) -High quality

Moody's Ratings of Short-Term Municipal Notes

Short-term securities issued by states, cities, counties, and other local governments are rated by Moody's as to their investment quality. For these short-term issues Moody's uses the rating symbol MIG, meaning Moody's Investment Grade. As shown below, only four rating categories are used and speculative issues or those for which adequate information is not available are not rated. The rating categories are as follows:

MIG I

Loans bearing this designation are of the best quality, enjoying strong protection from established cash flows of funds for their servicing or from established and broad-based access to the market for refinancing, or both.

MIG2

Loans bearing this designation are of high quality, with margins of protection ample though not so large as in the preceding group.

MIG3

Loans bearing this designation are of favorable quality, with all security elements accounted for but lacking the undeniable strength of the preceding grades. Market access for refinancing, in particular, is likely to be less well established.

MIG4

Loans bearing this designation are of adequate quality, carrying specific risk but having protection commonly regarded as required of an investment security and not distinctly or predominantly rationale. The rating committee then discusses the information submitted. It may or may not change the rating, depending on the facts of the case. If the rating is not changed and issuer continues to disagree with the rating, then the issuer has an option of not accepting the rating. Recently, SEBI1 has mandated CRAs to publish such unaccepted credit ratings on their website. Hence in line with these guidelines, the unaccepted ratings shall be disclosed on CRISIL's website

Publication of accepted ratings

The accepted ratings are disseminated to CRISIL's subscriber base, and to local and international media. Rating information is also updated online on www.crisil.com, the CRISIL website, in the form of a rating rationale, which provides information about the company, rated instrument, assigned rating and outlook, rationale for assigning the rating, applicable criteria, etc.

Also, CRISIL, in compliance with International Organization of Securities Commission (IOSCO) code of conduct, publishes a more detailed credit rating report (CRR) on its dedicated website, www.crisilratings.com. The publication of the CRR ensures transparency in CRISIL's ratings methodologies and assumptions and also enables investors to understand how CRISIL arrives at a rating. In addition, CRISIL publishes credit insights derived from its rated universe through periodic publications called Ratings Roundup (published semi-annually) and Default Study (published annually).

Timeframe

From the initial management meeting to the assignment of rating, the rating process can take up to four weeks, but CRISIL sometimes arrives at rating decisions in shorter timeframes to meet urgent requirements.

Surveillance

All CRISIL ratings are under continuous surveillance. After a rating has been assigned, CRISIL continues to monitor2 the performance of the issuer and the economic environment in which it operates. The surveillance process ensures that the analysts are updated on current developments, review sensitive areas, and learn about changes in issuer's plans. CRISIL's analysts maintain periodic contact with the issuer and ensure that financial and other information are shared with CRISIL regularly. Moreover, CRISIL endeavours to interact with issuer's management at least once a year. These interactions essentially focus on developments over the period since the last interaction, and the outlook for the coming year.