A STUDY ON THE FINANCIAL PERFORMANCE OF CREDIT RATING AGENCIES IN INDIA

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ABSTRACT

For the sake of their own safety and the certainty of a profit on their bond investments, private investors rely on ratings. Credit Rating Agencies offer ratings to issuing firms based on their creditworthiness. There are no strings attached to this piece of advise. Financial soundness of issuers, however, is taken into account when rating most bonds. Credit rating agencies' financial performance was studied for 15 years in this context. Credit Rating and Information Services of India Limited (CRISIL), ICRA, CARE, Fitch, and Brickwork Ratings India Private Limited financial indicators such as revenue, profit before tax, earnings per share, net worth, dividend, market capitalization, and the number of employees are the focus of the current study. CRISIL, ICRA, CARE, Fitch, and Brickwork Ratings have a considerable difference in dividend payout ratio, earnings per share, and pre-tax profit before tax when compared to CRISIL, ICRA, and CARE, Fitch. It is the rating component that is given by rating agencies to any investor making investment choices in debt securities.

KEYWORDS

CRISIL, the rating agency, revenue, and the global financial crisis are all part of the same package here.

INTRODUCTION

Credit rating firms have played a significant role in the Indian financial markets since 1987, when regulation and credit rating were still in their infancy. Because credit rating companies back then were small in number and focused exclusively on the initial credit rating, legislation in place at the time had little power to regulate them. Ratings, grades, and other services provided by credit rating organizations have steadily increased over the last two decades. An increase of almost 1,0000% occurred in the number of instruments graded. SEBI restructured the regulatory framework in order to ensure that rating assignments and quality service to issuers were maintained in the wake of the rapid development of rating agencies. Prior to and during the global financial crisis of 2001-2015, strict rules for credit rating organizations were implemented. As a result of this, SEBI has been taking steps to control credit rating agency operations and disclosures.

Assigning credit ratings, which evaluate a debtor's capacity to repay debt by making regular interest payments and the possibility of default, is the job of a credit rating agency Following the implementation of the New Economic Policy, credit rating agencies gained prominence (1991). For products such as Commercial Papers, Debentures with a maturity duration of 18 months, and Non-financial Companies Fixed Deposits, credit rating was made necessary in India. All debt instruments must now be given a Credit Rating as of March 1998. Merchant Bankers and Brokers were the sole sources of information on the risk of a specific issue prior to the founding of Credit Rating Agencies. Merchant bankers' jobs have been greatly simplified thanks to the Credit Rating Agencies.

REVIEW OF LITERATURE

Financial regulators should mandate that financial institutions including banks, broker dealers, and insurance companies employ credit spread when estimating portfolio risk, according to Tabrez Ahmed's (2009) research, rather than relying on credit rating agencies' (CRAs) ratings.

By proving default probability and recovery rate, Jaydev M et al (2010) identified the main portion of the difference in credit spreads across various rating categories. Structural models dictate that the relationship between credit spreads and key credit risk variables be the same as it is in practice. So, poll-based spreads might be a positive step in the

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development of the bond and credit derivative market for developing markets.

According to Avinash D Persaud (2010), rating agencies do not have the business model of analysts who earn multimillion dollar incentives. Ratings, however, are just as important to the present rate and relocation model of banking as analysts' recommendations were to the dotcom boom. Certain merchants and some banks were resembling each other more than they were like one other. Anger at credit rating agencies and requests for regulation have been blamed for the subprime crisis's downfall, it was emphasized.

Based on investors' choices to compare several instruments of many firms at once and to depend on credit rating for their investment decision, Kuljeet Kaur et al (2010) concluded that investors' satisfaction with credit rating was high. There is a correlation between the rating features of safety and time and energy savings for investors and the ability to make better decisions, according to the study. Investors are more satisfied when the ratings of the instruments are revised by the rating agencies, since they reflect the real value of the instruments. Investors' dissatisfaction is exacerbated by their preference for long-term investments and the participation of rating agencies in the research process. Credit rating companies should be held to a higher standard of accountability, according to the report.

After the recent satyam event, Shobha Kannan (2010) observed that Ratings Agencies seek to increase their due diligence and improve their rating technique. Companies' audited balance sheets serve as the main data source for rating agencies. The basic accounts of a corporation are not examined by rating agencies. As a group, the rating agencies should take further steps to guarantee that ratings are consistent.

CRISIL, ICRA, CARE and FITCH were appraised by Bheemanagauda and Madegowda (2010) for their performance in India. The study relied on data from 2000-08 on long-term debt instruments to conduct their research. The findings of the research show a significant rise in the rating business in India throughout the time period studied. Investment-grade ratings are given to the greatest number of instruments throughout the research period. The analysis shows that the number of downgrades exceeded the number of upgrades in both the number of instruments and the amount of debt. The ratings were shown to be dependent on the issuer. Because of this, the authors proposed that strict measures be used to prevent repeated downgrades. Furthermore, it shows that Fitch India ratings is the most stable ratings agency, followed by CRISIL, ICRA, and CARE in that order.

Roopa Kudva (2011) predicted a decrease in GDP from the previous estimate due to the worsening global economic condition and the gloomy investment climate in India as a result of the policy environment in India. Also projected was a greater than expected effect of higher interest rates and less government spending on the economy in developed nations.

CRISIL assigned a grade of 1 to Bhagawati Banquets and Hotels, which delivered 106 percent returns, whilst Parabolic Pharma received a grade of 4 for having above-average fundamentals but losing 83 percent of its value to shareholders. There was an increase in ratings, a decrease in connection between ratings and market indicated rates, and a decline in the effectiveness of ratings to anticipate default.

Batta and Maslu (2011) examined the credit rating agencies' changes to corporate profits with equity analysis. It is more difficult for credit rating agencies and stock analysts to accurately estimate a company's profitability when its operations and future are in doubt. In the case of a rise in the credit risk of a highly rated firm, agencies might refer to inputs as proof of their concern. In other words, rating agencies soften their rating models to provide more optimistic ratings than would be indicated from harsher inputs such as adjusted profits.

IMPORTANCE OF THE STUDY

Credit Rating Agencies were started to evaluate the risk involved in the instruments. The primary purpose of such rating assignment is to take necessary investment decisions by the prospective investors. On the transition of liberalized economy, the Credit Rating Agencies have been providing various categories of services to educate and bring awareness among investors. In this process the investors can also seek advice from experts who have undergone such investing experience. These agencies have been assisting the investors since last twenty years. The historical realities of Credit Rating Agencies have been under surveillance of regulatory authority. Even after such steps, Credit Rating Agencies could not assess the failure of performances in respect of borrowing companies. The rating agencies could not also deduce the fraudulent practices of WorldCom (2002) and Enron (2001).

STATEMENT OF THE PROBLEM

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The credit rating agencies assign the ratings to debt instruments. These ratings are backbones for the investors to decide. The earnings of the investors will be based on their decision to invest. Similarly, the earnings of credit rating agencies have any reflection on the returns in these agencies to the shareholding agencies.

OBJECTIVE

To assess the financial performance of credit rating agencies in the pre and post global financial crisis.

HYPOTHESES

- The hypotheses developed and tested are as follows.
- There is no significant relationship between Dividend Payout Ratio of CRISIL, ICRA and CARE Rating Agencies.
- There is no significant difference between Earnings Per Share of CRISIL, ICRA, CARE and BRICKWORK RATINGS.
- There is no significant difference between Profit Before Taxation of CRISIL,ICRA and CARE Rating Agencies.
- There is no significant difference between Ratios of Revenue of CRISIL,ICRA and CARE Rating Agencies.

RESEARCH METHODOLOGY

The study covers four credit rating agencies. The data used for the present study includes secondary data which was collected from official websites of Credit Rating Agencies. The financial information provided by various credit rating agencies is taken for the present study through financial analysis techniques. The other dimension of financial performance was by use of single factor ANOVA.

RESULTS AND FINDINGS

The findings of the study show that there is significant difference between dividend payout ratio of CRISIL,ICRA and CARE. The dividend payout ratio of these three agencies has been considerably good because the confidence built by the debenture holders in their ratings is high. The earnings per share of CRISIL, CARE,ICRA and Brickwork Ratings has also not shown any significant difference. This indicates that the commitment of the agency is known through the skill and knowledge employed by its staff. Among the three top credit rating agencies the profits are significantly different.

CONCLUSION

The result of study states that the profits are high in the rating agencies due to their empowered organizational commitment of more number of rating debt instruments. It was also found that there exist positive and significant relationship between the dividend payout ratio and earnings per share in all the three rating agencies. It could be concluded that the influence of various financial indicators has been varying in all the four credit rating agencies.

LIMITATIONS

The study is limited to a period of 2001 to 2015.
The data available in the secondary source is considered for the present study.
The financial indicators are focused from the view of credit rating agencies.

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