Credit Rating Agency: A Tool against Financial Risk

Dr. Himanshu Mathur[1] Mr. Sandeep Songara[2] Ms. Shruti Mishra[3] Ms. Laxmi Jangid[4]

[1,2,3,4]Assistant Professor

[1,2,3,4]Department of Management & Commerce

[1,2,3,4]Faculty of Education & Methodology, Jayoti Vidyapeeth Woman's University Jaipur, India

Abstract— Credit rating plays a significant role in financial market for investor, banks, financial institutions, and mutual fund etc. in reducing the asymmetrical information between different parties. Credit rating helps us to know the solvency power of borrowers which reduce the financial risk of the investor. The objective of this paper is to get in-depth knowledge of credit rating, credit rating agencies, and their ratings. The whole study is depends upon secondary data. The result of the study shows that due to credit rating, the chance of financial risk becomes low but on the other hand Investors should observe caution while investing their money and be aware themselves before taking their investment decisions.

Keywords: Credit Rating, Investor, Banks, Risk

I. Introduction

The banking sector plays very important role in development of the economy. Credit rating is one of the very important concepts in the banking industry. Credit rating is a method to analyze the solvency or paying capacity of borrowers. It works as a safer tool for banks to take decision regarding loaning.

Many credit rating agencies are working in the market and they provide required information about borrower's financial and paying capacity. In other words, credit rating shows the creditworthiness of borrowers and chance of payment of principal and interest amount. Credit rating provide number of benefit the following ways-

A. *To Investor*

1) It is helpful in taking investment decision
2) Assurance of safety of loan amount
3) Easy understanding of investment proposal
4) Save time and cost

B. *To Company*

1) Improve corporate goodwill
2) Lower cost of borrowing
3) Good for non-popular company
4) Helps in growth

II. Key functions of Credit Rating Agencies

- Low-cost information
- Provides a basis for suitable risk and return
- Helps in the formulation of Public policy.
- Provides superior information
- Enhances corporate image

A. *Review of Literature*

1) Sunitha, G., & Sanjeev, Rinku, 2018, the author has done study to know the impact of credit rating agencies in India's development. He used analytical & descriptive research and both primary and secondary data were used for the study. This study explains steps which result in development of the country and know the living standard of people.
2) Carol Ann Frost, 2007, the author has done his study on credit rating agency in the capital market: a review of research evidence on selected criticisms of the agencies. This paper analyzes significant criticisms of the credit rating agencies discussed in a recent Securities and Exchange Commission (SEC) staff report by using evidence from empirical research studies, and suggests many promising subjects for future research.
3) Savita Shankar, 2019, the theme of this paper is to describe the common financing challenges faced by various micro, small, and medium sized enterprises (MSMEs) in India and some important measures taken to address them, with a focus on the credit rating scheme implemented in 2000. The result of study shows that credit rating is an expensive exercise, the availability of government subsidies under the scheme has been an important factor in encouraging MSMEs to get themselves rated, thereby reducing information asymmetry with banks and enabling access to credit.[3]

III. Research Methodology

Research methodology is to search for gaining knowledge or to study impact of one variable on another variable. Research methodology is helpful to get an idea or knowledge about a particular topic.

A. *Objective of Study*

1) To get knowledge about credit rating concept.
2) To study various credit rating agency working in India

B. *Data collection*

The secondary data was used for the study. Data was collected from various sources like Journal, Magazine, Books, Research papers and Websites.

C. *Type of research*

The study is Descriptive research in nature. Descriptive research is a type of research that is used to describe the features of the phenomenon that is being studied.

IV. Top Credit Rating Agencies and their Rating Process

Credit Rating Information Services of India Limited (CRISIL) – It is one of the oldest credit rating agencies in India. The company came into existence in the year 1987 and its Headquarter is situated in Mumbai. The company operates its working from 8 countries including India, US, UK, Singapore, China, Poland, Argentina, and Hong Kong. The company provides ratings, analytics, and solutions, research with a very good track record of innovation and growth.[4]

Rating scale for Long-Term Instruments

CRISIL AAA (Highest Safety)	Instruments with this rating are considered to have the highest degree of safety regarding timely servicing of financial obligations. Such instruments carry lowest credit risk.
CRISIL AA (High Safety)	Instruments with this rating are considered to have high degree of safety regarding timely servicing of financial obligations. Such instruments carry very low credit risk.
CRISIL A (Adequate Safety)	Instruments with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk.
CRISIL BBB (Moderate Safety)	Instruments with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations. Such instruments carry moderate credit risk.
CRISIL BB (Moderate Risk)	Instruments with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations.
CRISIL B (High Risk)	Instruments with this rating are considered to have high risk of default regarding timely servicing of financial obligations.
CRISIL C (Very High Risk)	Instruments with this rating are considered to have very high risk of default regarding timely servicing of financial obligations.
CRISIL D Default	Instruments with this rating are in default or are expected to be in default soon.

Fig. 1: source- https://www.crisil.com/en/home/our-businesses/ratings/credit-ratings-scale.html

V. ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) started in 1991 by leading financial institutions, commercial banks, and financial services companies as a sovereign Credit Rating Agency. It is the second largest rating agency which was established in the year 1991. It is a public limited company and its head office is situated in New Delhi. The international Credit Rating Agency Moody's Investors Service is one of the largest shareholders of it.

1) ICRA] A1: Instruments with this rating are considered to have very strong degree of safety regarding timely payment of financial obligations. Such instruments carry lowest credit risk.
2) [ICRA]A2: Instruments with this rating are considered to have strong degree of safety regarding timely payment of financial obligations. Such instruments carry low credit risk.
3) [ICRA]A3: Instruments with this rating are considered to have moderate degree of safety regarding timely payment of financial obligations. Such instruments carry higher credit risk as compared to instruments rated in the two higher categories.
4) [ICRA]A4: Instruments with this rating are considered to have minimal degree of safety regarding timely payment of financial obligations. Such instruments carry very high credit risk and are susceptible to default.
5) [ICRA]D: Instruments with this rating are in default or expected to be in default on maturity.

VI. CARE

It was started in April 1993 over 25 year; it is one of the largest rating agencies in India with rating volume of debt is around Rs. 128.37 Lakh Corers. CARE rating has emerged as one of leading agency which covers any rating segments includes manufacturing, infrastructures, financial sector etc.

Symbols	Rating Definition
CARE AAA	Instruments with this rating are considered to have the highest degree of safety regarding timely servicing of financial obligations. Such instruments carry lowest credit risk.
CARE AA	Instruments with this rating are considered to have high degree of safety regarding timely servicing of financial obligations. Such instruments carry very low credit risk.
CARE A	Instruments with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk.
CARE BBB	Instruments with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations. Such instruments carry moderate credit risk.
CARE BB	Instruments with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations.
CARE B	Instruments with this rating are considered to have high risk of default regarding timely servicing of financial obligations.
CARE C	Instruments with this rating are considered to have very high risk of default regarding timely servicing of financial obligations.
CARE D	Instruments with this rating are in default or are expected to be in default soon

Table 1: source- http://www.careratings.com/resources/rating-resources.aspx

VII. CONCLUSION

Credit rating evaluates solvency capacity of individual, firm or even a country and shows the credit capacity of credit history. Credit rating is calculated from financial history and firm's current liabilities and assets. A credit rating shows lender or investor the probability of subject being able to pay back a credit amount. Commercial bank, mutual fund, investment bank, and insurance companies require the service of credit rating. A rating assigned does not always remain same forever. It is revised from time to time because of number of factor affect performance of firm or individual like economic environment, corporate restructuring, management of the organisation, etc. therefore the need of revision of ratings arises. If ratings are assigned in a systematic and transparent way, then it will be an advantage for investors and will go a long way in making the investment world a safe place.

However, the law of Caveat Emptor which means 'let the buyer beware' should not be ignored. An investment cannot be risk free. Investors should observe caution while investing their money and be aware themselves before taking their investment decisions. It is equally important for individuals to maintain their good credit history by repaying loans on time and not breaching any rules of law in respect of investments, taxation, etc.

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