Research article Available online www.ijsrr.org ISSN: 2279–0543

International Journal of Scientific Research and Reviews

Credit Rating in India: A Study of Rating Process and Methodology of Rating Agencies with Reference to CRISIL and ICRA

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ABSTRACT

Credit rating is a significant instrument for the borrower to gain access to loans and other liabilities. It is an alpha numeric symbol that gives overview about the protection and creditworthiness of an entity. Credit rating gives a entire description of the risk associated with the financial instrument or the issuer, taking into consideration that past performance, present situation and future prospects and utilize both quantitative and qualitative facts in measurement the creditworthiness of borrowers. It is the symbolic indicator of the current estimation of rating agencies regarding the relative ability of issuer of debt instrument, to service the debt obligations as per term and conditions. The organization with particular function namely, assessment of the profitability of the timely payments by an issuer on a debt is recognized as credit rating agencies. The main purpose of the paper is to assess the reliability in rating process and methodology of each individual rating agency by taking CRISIL and ICRA companies. The study also explains the general awareness about credit rating and credit rating agencies in India

KEYWORDS: Credit rating, Credit rating agencies, Process, Methodology, Credit quality, CRISIL and ICRA

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INTRODUCTION

Credit rating is an important technique for the borrowers to gain the access to loans and other obligations. Good credit ratings permit borrowers to easily borrow money from banks or financial institutions or debt markets in India. The credit rating agencies in India are regulated by the SEBI (Security Exchange Board of India). As far as the constancy in rating methodology of each rating agency by taking corporate belonging to the same rating class is concerned, it has been found that there has been consistency to a large extend in the methodology of all the rating agencies while assigning a particular rating scale whereas there has been discrepancy in the method adopted by all the four rating agencies while assigning different rating grades. The analysis gives that since rating change ratio is concerned, the largest number of rating change cases is related to FITCH followed by ICRA and CRISIL. Good rating from CRISIL takes weight with lenders, it helps build credibility of your business and gain confidence of business partners get your story to the world by getting the rated.

Need and Importance of the Study

Credit rating is used as crucial inputs in shaping the investment portfolio. Credit rating agencies play an important role in giving the services and information; therefore assist the investment in assessing the risk. There is a need to recognize the ratings of the credit agencies as an investor uses the risk phases and compares the offered rate of return trade off before making the investments and get expected rate of return to optimize. Credit rating plays a vital role in financial markets by obligations in the country.

Objectives of the Study

- To study the general awareness about credit rating and credit rating agencies in India.
- To study and compare the rating methodology, process of CRISIL AND ICRA.
- To study the process of Indian credit rating agencies.

MATERIALS AND METHODS

The study is based on the secondary data and which comprises two SEBI recognized rating agencies including CRISIL, ICRA and the data regarding a range of rating grades has been composed from the reports of the rating agencies including various issues of CRISIL rating scan and CARE rating view and website of these rating agencies. .

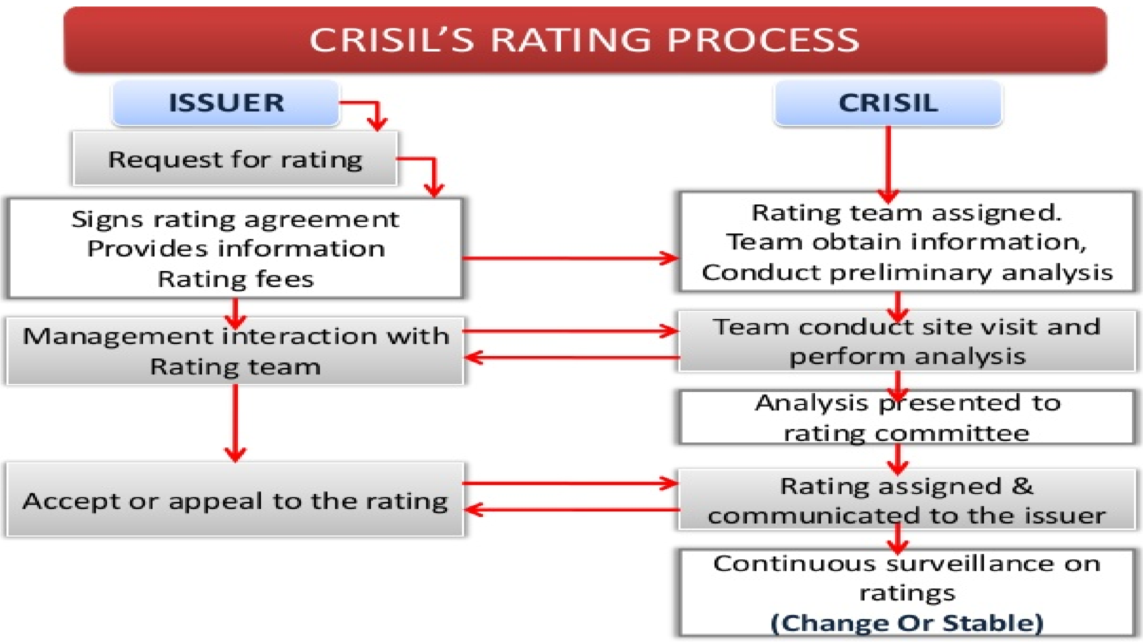
CRISIL's Rating Process

CRISIL's analysis of each credit is carried out by a multi-member rating team. The analysis is based on information obtained from the issuer, and on an understanding of the business environment in which the issuer operates. It is conducted within the framework of clearly delineated rating criteria. The analysis is then presented to a rating committee, comprising members with professional experience and expertise to meaningfully assess the credit. The rating committee approach entails credit assessment of an entity by a group of experienced professionals, thereby ensuring objectivity of the rating.

Preliminary Analysis and Management Interaction

The rating process begins with a rating request from the issuer. Thus, the rating contract is signed and the fees are collected from the issuer. All the interactions with regard to rating fees are carried out by CRISLs' business management team and there is no participation of CRISIL's investigative team in the process. When the process is completed, an analytical team is assigned the accountability of analyzing the issuer's credit risk profile. These rating team then assembles preliminary information from the issuer to understand its business, management, and financial risk profiles. CRISIL considers that investor interest is best served if there is an open dialogue between the issuer and CRISIL. This enables CRISIL to incorporate non-public information into its rating decision and also helps it arrive at forward-looking ratings.

Stages in the process for a credit rating assignment



Source: crisil.com http://crisil.com/ratings/rating-process.html

Figure 1: Shows the Process CRISIL's Rating Process

Rating Committee and Assignment of Ratings

CRISIL's analysts organize a report detailing their evaluation and assessment of business risk, financial risk, and management risks which has been associated with the issuer. The report is based on rating methodologies and the criteria that are clearly spelt out, published and constantly applied. The report is then presented to the rating committee. This is merely factor of the process in which the issuer does not directly participate. The rating committee includes knowledgeable professionals who bring with them wide experience in credit evaluation and assessment. The rating committee provides a rating after through discussion on the report prepared by the experts.

Communicating the Rating to the Issuer

On finalization of a rating at the RCM, the rating decision is conveyed to the issuer. Thereafter, a document (rating rationale) emphasizing the key causes for assigning the rating is shared with the issuers. This is to help the issuer in undertaking the main analytical factors that have been assessed for arriving at the rating decisions.

Publication of Accepted Ratings

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

Timeframe

From the preliminary management meeting to the assignment of rating, the rating process can take up to four weeks, but CRISIL sometimes arrives at rating choice in shorter time limit to meet urgent requirement. In such a case, the issuer needs to submit additional facts or data.

Withdrawal of Ratings

CRISIL ratings are not one time exercise and it is a continuous observation over the life of the rated ability or instrument. CRISIL's policy for withdrawal of rating stipulates that ratings on instruments or facilities (such as bonds, debentures or term loans), which have scheduled repayments dates, may be withdrawn only on maturity or redemption of the rated instruments or facilities. The rating may also be withdrawn if the rated amenities are pre-paid by the borrower, with the lender's consent. In either case, CRISIL takes confirmation from either banks or auditors on whether the facility has been paid off.

Confidentiality

A considerable part of the information discussed by the company is highly sensitive and confidential, and is provided by the issuer only for the objective of arriving at the rating. Such information is set aside severely confidential by the ratings team and not shared with other group company of CRISIL doesn’t disseminate confidential information about entities it rates. However, in accordance with recent SEBI guidelines, CRISIL has started to disclose unaccepted ratings on its website from January 2017.

Rating Methodology of Credit Rating Agencies

The rating methodology at CRISIL takes into consideration the issuer company’s track record in addition to projecting the future cash flow adequacy. the factors that play a vital role in formative credit ratings are company risk evaluations, market position, financial aspect, project risks, and support from a strong parent. Audited results form the starting point of credit assessments, and the rating agency does not perform a forensic analysis of financial statements.

Overall the rating methodology at CRISIL factors in the following parameters:

(i) Accounting Quality and Existing financial position

(ii) Cash flow adequacy and financial flexibility

(iii) Management risk (stand-alone credit risk, parent support)

(iv) Business risk (includes project risks) and Future financial position

Rating Process of ICRA

The rating process at ICRA is started on the receipt of a proper demand from the prospective issuers. A rating management team, which normally consists of two analysts with the required expertise in the domain area, is involved with the rating assignment. An issuer is given a list of the facts requirements and the broad framework of planning. These necessities are worked out on the basis of ICRAs consideration of the issuer's business and broadly wrap at the factors that may have a bearing on the rating. ICRA process also draws on secondary sources of information, including its own research division while working on the rating task.

ICRA’S RATING PROCESS

- Issuer requests for a rating
- Issuer signs rating agreement and pays the rating fee
- Issuer provides information
- Analysts process the information and meet the management/bankers/auditor
- Rating report prepared by analysts
- Rating committee assigns rating
- Communication of rating to the issuer
- Decision of the issuer

Request for Rating

ICRA initiates the rating process on the basis of request made by the prospective issuer. The terms of rating assignment relate to some important issues such as — commitment of the credit rating agency to maintain confidentiality of the crucial information submitted by the issuer company, the right to the issuer to accept or not to accept the rating, issuer furnishing the information as required by the credit rating agency for rating.

Rating Experts and Information Needs

Rating is conducted by a team which is comprised of two members. The members will have expert knowledge in evaluating the business of the issuer. The issuers are required to provide a list of information and a broad framework for discussion. As rating process involves a detailed analysis of the financial competence and operating

Meetings and Discussions with the Management

Rating involves assessment of not only quantitative factors but qualitative factors as well. An analysis of qualitative factors is intended to estimate the future earnings of the issuer. This calls for intensive discussions with the management of the issuer company regarding plans, future outlook, and competitive position and funding policies.

Meeting of the Rating Committee

Rating committee is vested with the final authority for assigning ratings. The rating committee presents a brief picture about the business and management of the issuer. Moreover, the issues identified by the internal committee are also discussed in detail. Finally, on the basis the recommendations of the internal committee, rating is assigned by the rating committee.8. Communication of rating.

Review of Ratings

When the ratings are not acceptable to the issuer, he can appeal for a review of ratings. Such review is made on the basis of further information furnished by the issuer relating to the factors that were considered for assigning the rating. If the results of the review are satisfactory, the committee can revise its initial rating decision.

Revision of Ratings

The credit rating agency monitors the accepted ratings over a period of time. As per the terms of the rating assignment, the issuer is bound to provide information to the credit rating agency for the periodical review of the ratings. On the basis of the review, the initial rating can be retained or revised.

Rating Methodology at ICRA

Rating methods include an assessment of various aspects that have a bearing on the future cash production of the issuer. The process includes estimating the issuer's ability to generate cash from the procedures and assessing the sufficiency of the estimate visa –vis the issuer's debt servicing liabilities over the term of the instrument. Moreover, the rating process likewise the rating process also involves assessing the cash flows hold up that may be obtainable to addition the equipped cash flows. These aspects includes industry distinctiveness, competitive position of the issuer, management quality, operational competence, assurance to new projects and other associate companies and finance policies of the issuer. A complete analysis of the past financial statements is made in addition to evaluate of future earning under various compassion situations and evaluated against the claims and obligations that necessitate servicing over the occupancy of the tool being rated. Mainly, it is the relative comfort level on the issuer's cash flows to services obligations that finds the rating.

RESULTS AND DISCUSSIONS

Downgrades by ICRA saw a 7% Decline During 2017

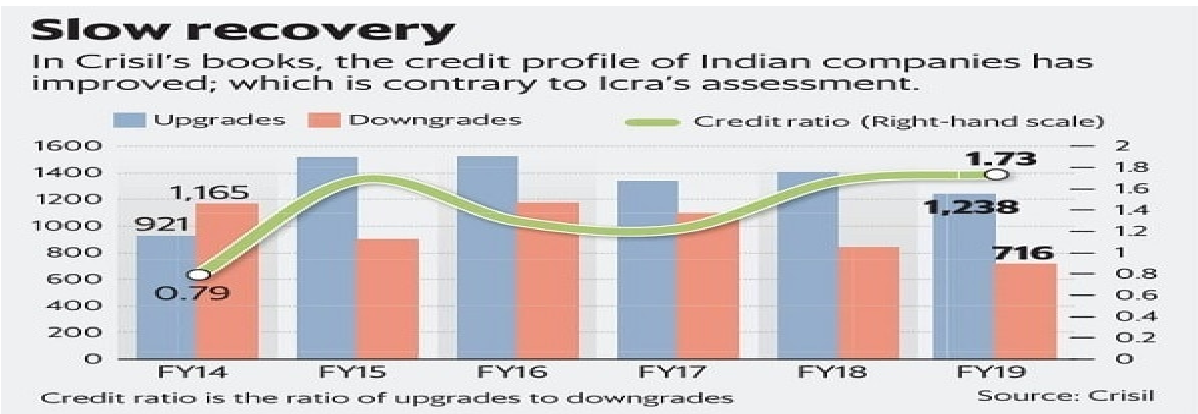
There were however, fewer upgrades. "The trend in both the number of companies upgraded and value of the debt upgraded (of these companies) has been on a declining curve. These trends reflect ongoing phase of stabilization in credit quality of entities, having faced significant deterioration in recent years," ICRA said in a statement. Auto and auto ancillaries, pharmaceuticals and chemicals were among sectors where upgrades topped downgrades. "Total debt upgraded and total debt downgraded reached their respective five-year highs and lows in fiscal 2017. These indicate a gradual improvement in credit quality of India Inc," CRISIL said in its annual Ratings Round-Up. The improvement was driven by higher commodities prices, lower interest costs, stable macro-economic parameters and better capital structure.

A day after largest rating agency, CRISIL, released its findings and outlook on credit quality of India Inc, ICRA also confirmed that further credit quality pressures have eased and volume of the debt downgraded decreased sharply in FY17 compared to FY16. "While incremental downgrade pressures have subsided, the prospects of a definitive improvement in credit quality are not reassuring as yet. The pace of improvement would only be gradual as businesses adjust to and recover from balance sheet stress, tracing the recovery in business growth and improvement in capacity utilization," it said in a note.

In FY17, ICRA upgraded the ratings of 603 entities and downgraded the ratings of 517 entities. While the proportion of entities downgraded has broadly remained in the range of 7-8 per cent for three consecutive years, the value of the debt downgraded has been reducing. Value of debt downgraded significantly reduced to Rs. 1.7 trillion in FY17 from Rs. 3.0 trillion in FY16, according to ICRA. Sectors where the number of upgrades exceeded downgrades were auto and auto ancillaries, pharmaceuticals and chemicals. Sectors such as gems and jeweler, engineering and metals continued to account for a large share of downgrades. While ICRA projects the gross nonperforming assets of banks to increase to 9.9-10.3 per cent by FY18 end (9.5 per cent as on December 31) because of possible slippages from large accounts under the "standstill clause" pertaining to the various schemes for resolution of stressed assets, this is unlikely to result in a material increase in the value of the debt that may be prone to downgrades. ICRA expects consumption-oriented sectors like automobiles, consumer durables, food products and FMCG to revert to their earlier growth trajectory and continue their superior credit profiles compared to investment-oriented sectors such as capital goods, real estate, building materials, metals and telecom.

How to anticipate a downgrade.

If the rating viewpoint is not positive, usually the ratings are likely to be reducing further. In the case of a bank, find out its non- performing asset (NPA) levels or bad debts or loan, if evaluated to peers, its NPAs have been rising ; change are it could face further downgrade. In the case of a company, give close consideration to its debt equity (DE) ratio and interest coverage rate.



Source: crisil.com http://crisil.com

Figure 2: Shows the Trends of Credit Profile in the CRISIL's Books

In CRISILs books, the credit profile of Indian companies has been improved, which is being contrary to ICRAs assessment. CRISIL rating says there is broad- based and continued improvement in corporate credit profile. ICRA declares Indian companies are still under considerable stress as its rating drift has doped to negative -12%. Has the credit profile of Indian corporate improved and have they reduced their debt load? It depends on which rating agency you want to believe. In its modernize on rating activities, CRISIL Ratings said that there is broad-based and sustained improvement in corporate credit profile. The firm saw upgrades exceed downgrades for fiscal year 2019 (FY19) indicating improved health of corporate balance sheets. CRISIL'S credit ratio, which is the number of upgrades to the number of downgrades, climbed to 1.81 for the October-March period from 1.68 in April-September. Companies have deleveraged their balance sheets to a large extent and have conserved their capital, the rating agency's officials said in a conference call with the media.

ICRA's rating actions in FY19 indicate a persistent pressure on the credit quality of India Inc. during the year. The stark difference between the two rating agencies could be partly because of the fact that debt of Infrastructure Leasing and Financial Services Ltd (IL&FS) group was rated by ICRA Ltd and CARE Ratings. CRISIL has no ratings on IL&FS. Since June last year, IL&FS began defaulting on its debt payments and, hence, the ratings of a clutch of group companies, including the parent, were downgraded sharply by ICRA. This is not the first time both rating agencies have differed. CRISIL and ICRA gave a contrasting picture of credit risk even for the first six months of FY19 before IL&FS began defaulting. To be fair, there are similarities in the opinion of both rating agencies as well. Both agree that stress is restricted to specific companies and is not broad-based. For instance, the downgrade of two telecom companies skewed the credit ratio for CRISIL, while for ICRA; it would be the IL&FS group effect. For investors, this means that the truth lies somewhere in between. Indian companies have indeed deleveraged, reflecting in the slow but steady progress of insolvency cases. But a healthy balance sheet is still some time away.

Credit Rate Symbol

Credit rating	Rating description
AAA	Prime
AA+	High grade
AA	
AA-	
A+	Upper medium grade
A	
A-	
BBB+	Lower medium grade
BBB	
BBB-	
BB+	Non Investment grade speculative
BB	
BB-	
B+	Highly speculative
B	
B-	
CCC+	Substantial risks
CCC	
CCC-	
CC	Extremely speculative
C	Default imminent
RD	In default
SD	
D	

Table 1: Showing Comparative Analysis of the Rating Agencies

Rating agency	CRISIL	ICRA
Formed	1987	1991
Rating process	3-4 weeks	Usually a month
Rating methodology	Accounting quality, financial position, cash flow adequacy, management and business risks	Business risk, industry risk, new projects risk, financial risks, management quality, issuer's competitive position
Ratings approved by	Rating committee	Rating committee
Review	Ratings under surveillance till validity	Surveillance annually till the tenor of the debt instrument
Businesses	Ratings, Research, Capital markets, Infrastrcture Advisory, Risk solutions, Executive Training, Global Research and Analytics (IREVNA,PIPAL)	Ratings, Research, Grading, Consulting, KPO, MFI.

Key Findings

- Rating agencies don't assess the rationality of the issues price, possibilities for capital gains or take into consideration the liquidity in the secondary market.
- The rating agencies don't make any representation or warranty to the completeness or timeliness of the information used by them during the rating process.
- Rating is relative measures of risk; as a result, the assignment of ratings in the same category to entities and obligations may not fully reflect small differences in the degrees of risk.
- In CRISILs books, the credit profile of Indian companies has been improved whereas in ICRAs case, the Indian companies are still under considerable stress as its "rating drift", which is again the upgrades to downgrades ratio, has dropped to negative.

CONCLUSION

The study concludes that the ratings are only an opinion on the relative ranking of the credit risk, they do not aspect in the other investment or market risks. Ratings are by and large based on audited corporate financial statement and credit ratings are the opinions on relative credit quality and not a projecting measure of specific default probability. The parameter and better capital arrangement the evaluations and assessments provided by various credit rating agencies provide investors with information and insight that facilitates their ability to examine and understand the risks and opportunities associated with various investment environments. The deterioration in corporate India's credit quality seems to have come to stop although fewer companies are seeing an improvement in their financial health.

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