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## **Accountability of Credit Rating Services - A Study**

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### **Abstract:**

*A rating is an opinion on the future ability and legal obligation of the issuer to make timely payments of principal and interest on a specific fixed income security. Credit Rating is a simple and easy to understand symbolic indicator of the opinion of a credit rating agency about the risk involved in a borrowing programme of an issuer with reference to the capability of the issuer to repay the debt as per terms of the issue. This is neither a general purpose evaluation of the company nor a recommendation to buy, hold or sell a debt instrument. The study is made with an empirical study and it includes field survey. A questionnaire schedule method was adopted to have the information from the actual as well as the potential customers of SSI units. The study has been conducted among the sample of 50 respondents. The opinions of the customers are the source of the conclusion. From the study it is clear that all customers preferred to get the credit rating from the ONICRA credit rating agency, which is very much important for each and every SSI units. It is powerful mode of business when the SSI gets credit rating to get financial assistance and to have better title.*

**Key words:** ICRA, SSI, Instrument, Finance, Debt and Customers

### **1. Introduction**

A rating is an opinion on the future ability and legal obligation of the issuer to make timely payments of principal and interest on a specific fixed income security. The rating measures the probability that the issuer will default on the security over its life, which depending on the instrument, may be a matter of days to 30 years or more. In addition, long term ratings incorporate an assessment of the expected monetary loss should a default occur. Credit ratings help investors by providing an easily recognizable simple tool that couples a possibly unknown issuer with an informative and meaningful symbol of credit quality. Credit Rating is a simple and easy to understand symbolic indicator of the opinion of a credit rating agency about the risk involved in a borrowing programme of an issuer with reference to the capability of the issuer to repay the debt as per terms of the issue. This is neither a general-purpose evaluation of the company nor a recommendation to buy, hold or sell a debt instrument Haque N.U. Kumar K, Mark N and Mathieson D (2000). People talk about quality whenever any paid service is being received by them from any individual or from any organization. They try to order according to the merit of these organizations in rendering services. Ordering the organizations based on their merit by using some alphabetical symbol is called rating. When someone says 'A1', he means that the service rendered by an organization is the best or better than the services rendered by the other organizations in the same field. Therefore, ratings in the field of finance are a simple and easily understood tool enabling the investor to differentiate between debt instruments on the basis of their underlying credit quality. Credit rating is thus a symbolic indicator of the current opinion of the relative ability of the issuer to service debt obligations in a timely fashion with specific reference to the instrument being rated. Rating is also a communicative tool. It communicates to investors the relative ranking of the different loss probability for a given fixed income investment, in comparison with other rated instruments Nickell P, W Perrudin and Varotto S (2000).

A rating is specific to a debt instrument and is intended as a grade, an analysis of the credit risk associated with the particular instrument. It is based upon the relative capability and willingness of the issuer of the instrument to service the debt obligations (both principal and interest) as per the terms of the contract. Thus a rating is neither a general purpose evaluation of the issuer, nor an overall assessment of the credit risk likely one be involved in all the debts contracted or to be contracted by such entity Rangarajan C (1998).

## 2. Need and Importance of the Study

ICRA credit ratings provide an investor with critical information to enable him to take an informed investment decision based on his risk-return preferences. These also help investors to select the appropriate investment opportunities from a large range of options available. Credit ratings are not recommendations to buy or sell or hold a specified rated security nor are they offered as guarantees or protections against default. They are opinions only. Specific credit rating opinions are not intended to measure many of the other factors that fixed - income investors must consider in relation to risk - such as liquidity risk, pre-payment risk, interest rate risk, risk of secondary market loss, or exchange loss risk. The rating is specific to the instrument and is not the rating of the issuer Kamesam V (2002).

## 3. Scope of the Study

ICRA ratings are based on an in-depth study of the industry as also an evaluation of the strengths and weaknesses of the company. The inherent protective factors, marketing strategies, competitive edge, level of technological development, operational efficiency, competence and effectiveness of management, hedging of risks, cash flow, trends and potential, liquidity, financial flexibility, government policies, past record of debt servicing, sensitivity to possible changes in business/economic circumstances are looked into. Once the company has accepted a rating, ICRA continuously monitors the corporate and the rating is monitored till the life of the instrument. The process is known as surveillance. During the surveillance period, all changes affecting the company are taken into account and the rating, if necessary, is changed, upwards or downwards. In other words, a rating is valid during the life of the instrument unless is changed. ICRA maintains absolute independence from market participants to provide unbiased opinions. The ratings are a result of collective judgment of committee members. ICRA's in-house research and database ensure that opinions are supported by objective benchmarks and comparison Shah A and Thomas S. (1997).

## 4. Research Methodology

The study is made with an empirical study and it includes field survey. A questionnaire schedule method was adopted to have the information from the actual as well as the potential customers of SSI units. The questionnaire highlighted the data identification as well as the note of various constraints faced by the respondents. The actual questionnaire schedule used for the purpose is annexed to the study. The survey was conducted on 50 customers belongs to different small scale industries. The researcher has adopted descriptive research design for conducting the survey where by the researcher would describe the satisfaction levels of the customers regarding obtaining the credit rating certificate. The researcher has decided to make use of both primary and secondary data to have clear-cut information on the study topic. The researcher has collected the first hand information for the survey through a structured questionnaire among the customers who requires credit rating certificate. The researcher has collected information through journals and other standard reference books on the subject. The information collected by the primary method have been systematically tabulated and analysed with the help of statistical tools like percentages, rank method and chi-square test. The information also has been depicted in the form of charts and diagrams.

## 5. Evolution of Credit Rating And

In 1837, there existed a financial crisis in America. Credit rating had its origin from there, Due to the crisis, financial obligation of many organizations in USA mounted up. The first mercantile credit rating agency was set up in New York in 1841. The purpose of establishing the agency was to rate the ability of the merchants to pay financial obligations. Robert Dun took over the agency later. It published its first rating guide in 1859. John Bradstreet set up the second credit rating agency in 1849. It published a rating book in 1857. In 1933, these two agencies were merged to form Dun & Bradstreet. In 1990, John Moody established Moody's Investor Service. He published in 1909 the Manual of Railroad Securities. Moody further published a rating of utility and industrial bonds in 1914 and the rating of bonds issued by American cities and other municipalities in the early 1920s. Poor's Publishing Company brought out their rating issue for the first time in 1916. Standard Statistics Company followed the suit in 1922. These two organizations were merged in 1941 to form a Standard and Poor's which was subsequently taken over by McGraw Hill in 1966. A number of credit rating agencies were set up in 1970s. These included the Canadian Bond Rating Services, Thompson Bank watch, Japanese Bond Rating Institute, McCarthy Crisitani and Maffei, Dominican Bond Service, IBCA Ltd., and Duff and Phelps Credit Rating Company.

The first credit rating agency established in India was the Credit Rating and Information Services of India (CRISIL). It was set up in 1987. This was followed by the setting up of ICRA in 1994. This was formerly called as Investment Information and Credit Rating Agency of India Ltd. Credit Analysis and Research Ltd. (CARE) was set up in 1994. In 1996, Duff & Phelps Credit Rating (P) Ltd. was set up by Duff & Phelps in association with Indian non-banking finance companies (NBFCs).

## 6. Beneficiaries of the Rating Services

The rating provides the investors with an independent and professional judgment of the credit quality of the instrument, which the individual investor would not otherwise be able to evaluate. Rating provides low cost supplement to the in-house appraisal system of organized institutional investors. The rating replaces name recognition by objective opinion. Large institutional and other investors also make use of these ratings to make investment decisions. The issuers of rated securities are expected to have an access to a wider investor base. Credit rating provides a basis for determining the returns compared to the risks involved or perceived. This could be a useful benchmark for issue pricing and result in savings in costs.

Intermediaries like investment and merchant bankers and other market players use the rating for pricing, in placement and marketing the issues. The ratings are used in case of asset securitisation and structured obligation. The rating makes the exposure levels and risk undertaking decisions easy. The regulators have set certain benchmarks and rules for various market intermediaries or financial intuitions, etc. based on the rating for investment, exposure and dealings.

## 7. Data Analysis

### 7.1. SSI Certificate of the Respondents

SSI Certificate is very much required by the small scale industries. This certificate will be given only when the small scale industries have their own plant and machinery worth of less than 5 crores. This also helps to get subsidy from the government of India through NSIC (National Small Industries Corporation).

| SSI Certificate | No. of Respondents | Percentage |
|-----------------|--------------------|------------|
| Yes             | 50                 | 100        |
| No              | 0                  | 0          |
| Total           | 50                 | 50         |

Table 1

Source: Questionnaire

From the above table, it is clear that out of 50 respondents, 50(100%) of respondents own SSI Certificate. Thus it is found that all the SSI units felt that they require certificate for smooth and better performance.

### 7.2. ISO Certificate of Respondents

ISO Certificate is an important instrument for SSI units. It reflects the quality of each units to win the markets and to have better position in business dealings.

| ISO Certificate | No. of Respondents | Percentage |
|-----------------|--------------------|------------|
| Yes             | 10                 | 20         |
| No              | 40                 | 80         |

Table 2

Source: Questionnaire

From the above table it is clear that out of 50 respondents, 10(20%) respondents own ISO Certificate and 40(80%) of respondents does not own ISO Certificate. This analysis reveals that the majority of the respondents does not own ISO Certificate and it is not mandatory to run their business operations.

### 7.3. Credit Rating Certificate of the Respondents

Credit rating certificate provides a better title to SSI units to get various financial assistance from different sources and to have qualitative strength to their operations and the certificates are renewable in nature.

| Details | No. of respondents | Percentage |
|---------|--------------------|------------|
| Fresh   | 40                 | 80         |
| Renewal | 10                 | 20         |
| Total   | 50                 | 100        |

Table 3

Source: Questionnaire

From the above table it is found that, out of 50 respondents, 40(80%) respondents are fresh applicants who are seeking for the certificate and the rest of the respondents about 10(20%) have already owns credit rating certificate.

### 7.4. Nature of SSI Operations

SSI has different operations according to their capital and the number the employees. It consists of various small industrial units who engage in automobile industries, plastic industries, chemical industries and packing industries.

| Details    | No. of respondents | Percentage |
|------------|--------------------|------------|
| Automobile | 30                 | 60         |
| Plastic    | 10                 | 20         |
| Chemical   | 7                  | 14         |
| Packing    | 2                  | 4          |
| Others     | 1                  | 2          |
| Total      | 50                 | 100        |

Table 4

Source: Questionnaire

From the above table, it is clear that out of 50 respondents, 30(60%) respondents belongs to automobile industries, 10(20%) belongs to plastic industries, 7(14%) belongs to chemical industries, 3(6%) belongs to packing industries and 1(2%) belongs to other industries. Thus it is concluded that majority of the respondents are from automobile industries and a minority of the respondents are from other industries.

#### 7.5. Financial Assistance of the Respondents

Requirement of financial assistance is an essential element of the credit rating activity in India. SSI units get better title to get financial assistance from various sources and subsequently if they opt for credit rating that could improve the activities of SSI to earn more returns.

| Requirement    | No. of respondents | Percentage |
|----------------|--------------------|------------|
| Below 10 lakhs | 40                 | 80         |
| Above 10 lakhs | 10                 | 20         |
| Total          | 50                 | 100        |

Table 5

Source: Questionnaire

From the above table, it is seen that out of 50 respondents 40(80%) of respondents requires financial assistance of below 10 lakhs and 10(20%) respondents requires financial assistance of above 10 lakhs. Thus it is clear that majority of the entire respondents requires financial assistance of below 10 lakhs.

#### 7.6. Financial Assistance Provided By Banker

Information of the banker is very much important in getting financial assistance through credit rating facility. Banks provides more financial assistance to SSI units.

| Bank           | No. of respondents | Percentage |
|----------------|--------------------|------------|
| Indian bank    | 15                 | 30         |
| IOB            | 10                 | 20         |
| SBI            | 10                 | 20         |
| Syndicate bank | 8                  | 16         |
| Canara bank    | 7                  | 14         |
| Total          | 50                 | 100        |

Table 6

Source: Questionnaire

From the above table it is found that, out of 50 respondents 15(30%) respondents belongs to the customers of Indian bank, 10(20%) belongs to IOB, 10(20%) belongs to SBI, 8(16%) belongs to syndicate bank and 7(14%) belongs to Canara bank. This it is clear that the majority of the respondents are the customers of Indian bank.

### 7.7. Annual Turnover

It is important to know the annual turnover of the SSI units. Credit rating agencies charges certificate fee according to the turnover of the SSI units.

| Turnover        | No. of respondents | Percentage |
|-----------------|--------------------|------------|
| Below 50 lakhs  | 40                 | 80         |
| 50 – 200 lakhs  | 6                  | 12         |
| Above 200 lakhs | 4                  | 8          |
| Total           | 50                 | 100        |

Table 7

Source: Questionnaire

The above table shows that out of 50 respondents 40(80%) respondents had turnover of less than 50 lakhs, 6(12%) respondents had turnover between 50 lakhs and 200 lakhs and 4(8%) respondents had turnover between 200 lakhs and above.

### 7.8. NSIC Assistance

National small industries corporation is a body of central government established by the Ministry of Government to assist through subsidy to various SSI units.

| Need  | No. of respondents | Percentage |
|-------|--------------------|------------|
| Yes   | 50                 | 100        |
| No    | 0                  | 0          |
| Total | 50                 | 100        |

Table 8

Source: Questionnaire

From the above table, it can be understood that out of 50 respondents entire respondents expressed their willing to get financial assistance from NSIC.

### 8. Obtaining the Credit Rating Certificate and Customer Satisfaction With Regard To Nature of the Industries of the Respondents

To find out the relationship between obtaining the credit rating certificate and customer satisfaction of the respondents, the researcher has adopted chi-square test as statistical tool to test the formulated hypothesis in the study.

- Ho There is no relationship between obtaining credit rating certificate and the nature of the industries of the respondents.
- H1 There is relationship between obtaining the credit rating certificate and the nature of industry of the respondents.

### 9. Obtaining the Credit Rating Certificate and Customer Satisfaction With Regard To Nature of Industry of the Respondents

| Nature of industries | O  | E  | (O-E) | (O-E) <sup>2</sup> | (O-E) <sup>2</sup> /E |
|----------------------|----|----|-------|--------------------|-----------------------|
| Automobile           | 30 | 10 | 20    | 400                | 40                    |
| Plastic              | 10 | 10 | 0     | 0                  | 0                     |
| Chemical             | 7  | 10 | -3    | 9                  | .90                   |
| Packing              | 2  | 10 | -8    | 64                 | 6.40                  |
| Others               | 1  | 10 | -9    | 81                 | 8.10                  |
|                      |    |    |       | Total              | 55.40                 |

Table 9

$$E[(O-E)^2/E] = 55.40$$

Calculated Value = 55.40

Tabulated value at 5% level of significance for degrees of freedom.

$$(5-1) = 4$$

Degrees of freedom = 4

So null hypothesis Ho is rejected. Thus there is relationship between obtaining the credit rating certificate and the nature of industry of the respondents.

### 10. Obtaining the Credit Rating Certificate and Customer Satisfaction With Regard To Information of the Banker

To know the relationship between obtaining credit rating certificate and the information of the banker, the researcher has adopted chi-square test as statistical tool to test the formulated hypothesis in the study.

- Ho There is no relationship between obtaining credit rating certificate and custom satisfaction with regard to information of the banker.
- H1 There is relationship between obtaining credit rating certificate and customers satisfaction with regard to information of the banker.

### 11. Obtaining the Credit Rating Certificate and Customer Satisfaction With Regard To Information of the Banker

| Banker         | O  | E  | (O-E) | (O-E) <sup>2</sup> | (O-E) <sup>2</sup> /E |
|----------------|----|----|-------|--------------------|-----------------------|
| Indian Bank    | 15 | 10 | 5     | 25                 | 2.5                   |
| IOB            | 10 | 10 | 0     | 0                  | 0                     |
| SBI            | 10 | 10 | 0     | 0                  | 0                     |
| Syndicate Bank | 8  | 10 | -2    | 4                  | .40                   |
| Canara Bank    | 7  | 10 | -3    | 9                  | .90                   |
|                |    |    |       | Total              | 3.80                  |

Table 10

$$E[(O-E)^2/E] = 3.80$$

Calculated Value = 3.80

Tabulated value at 5% level of significance for degrees of freedom.

$$= (5-1) = 4$$

Degrees of freedom = 4

So null hypothesis Ho is rejected. Thus there is relationship between obtaining the credit rating certificate and information of the banker.

### 12. A Summary of Findings, Suggestion and Conclusion

The findings, suggestion and conclusion of the earlier chapters are summarized in the following pages. The study has been a survey with the help of questionnaire, among 50 respondents using convenience sampling methods, to determine the consumer satisfaction on obtaining credit rating among the respondents. The summary has depicted the following findings. It is found from the table No.1 that entire 50(100%) respondents own SSI certificate. It is clear from the above findings that obtaining credit rating certificate is mainly influenced on those who owns SSI certificate. The table No.2 shows that 40(80%) respondents does not own ISO certificate. It is clear from the above findings that the obtaining credit rating certificate does not require ISO certificate.

It can be seen from the table No.3 that 40(80%) respondents does not possess credit rating certificate earlier. It is clear from the study that the new SSI units always urge to get the credit rating certificate. It is found from the table No.4 that 30(60%) respondents relate to automobile industries. Thus we can conclude that automobile industries prefer to obtain credit rating certificate. It is known from the table No.5 that 40(80%) respondents require financial assistance of less than to lakhs. Thus it is clear that the credit rating certificate mostly helps the SSI units to get sources adequate financial assistance from various sources.

It is found from the table No.6 that 15(30%) respondents had banking transaction with Indian Bank. It is clear that most of the respondents prefer to get financial assistance through credit rating from Indian bank. It can be seen from the table No.7 that 40(80%) respondents earns annual turnover of below 50 lakhs. It is clear that most of the respondents prefers for obtaining credit rating facility are average businessmen. It is found from the table No.8 that entire 50(100%) respondents requires the NSIC Assistance. It is clear that each and every SSI unit requires NSIC Assistance to get funds and concession from the government. The Chi-square test has proved that there is relationship between obtaining the credit rating certificate and the nature of industry of the respondents and obtaining the credit rating certificate and information of the banker.

#### 12.1. Suggestions

It is suggested from the study that only the credit rating agencies give an opinion regarding the general credit worthiness of the SSI and its performance. It includes an objective assessment of the SSI unit by credit rating agencies on operating performance, infrastructure facilities, viability of system, buyer's and vendors satisfaction, financial resources, credit worthiness, existing working capital arrangements, management style, motivational, commitment levels and life style of the promoters.

National small industries corporation (NSIC) which is a body of central government also plays a vital role in providing subsidies, advises to SSI and also assisting to credit rating agencies. All SSI units are advised to go through the process for future prospectus. SSI units are to be provided with required information with regard to the benefits of the credit rating and the procedures to be followed in obtaining the credit rating facility. Few small scale industrial units who require financial assistance prefer for the credit rating operations. It is suggested that all the small scale industrial units need to undergo the credit rating operations to claim vast resources.

### 12.2. Conclusion

Credit ratings are based on in depth study of the each and every activity of the SSI units and corporations. It reflects on marketing strategies, competitiveness, technological development, liquidity, financial flexibility and government policies. Credit rating is beneficial to investors, issuers, intermediaries and regulators. Onicra helps SSI nits who require financial assistance on their credit worthiness, financial viability and performance. Credit rating services are inevitable for bonds, debentures, fixed deposit programmes, commercial papers, structured debt obligations etc. The study has been conducted among the sample of 50 respondents. The opinion of the customers is the source of the conclusion. From the study it is clear that all customers preferred to get the credit rating from the ONICRA credit rating agency, which is very much important for each and every SSI units. It is powerful mode of business when the SSI gets credit rating to get financial assistance and to have better title.

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