CHAPTER - I

INTRODUCTION AND DESIGN OF THE STUDY

1.1 INTRODUCTION

Investment refers to acquisition of some assets. It also means the conversion of money into claims on money and use of funds for productive income earnings. In essence, it means the use of funds for productive purposes, for securing some objectives like, income, appreciation of capital or capital gain, or for further production of goods and services with the objective of securing yield. To the economists, “investment means net additions to the economy’s capital stock which consists of goods and services that are used in the production of other goods and services. In simple terms, investment is the sacrifice of certain present value for an uncertain future reward. It entails arriving at numerous decisions such as type, mix, amount, timing, grade of investment and disinvestment.

Instead of keeping the savings idle, investors may like to use their savings in order to get return on it in the future which is known as investment. There are various factors which affect investors’ attitude of investment such as annual savings, savings avenue, choice on investment portfolio, risk on portfolio, mode of accessing investment portfolio, experience in the field of investment, size of investment, investment horizon, sources of information and factors influencing decision of investors.

For all these reasons, investors carefully consider the impact on the credit rating every time they make financial decisions. Credit ratings are of
great practical importance, as they impact the firm’s cost of debt, its financial structure, and even its ability to continue trading. From the investment perspective, credit ratings are an independent source of credit analysis used by institutional investors at the operational level and for regulatory purposes and to limit its agency costs.

India was perhaps the first amongst developing countries to set up a credit rating agency in 1988. The function of credit rating was institutionalized when RBI made it mandatory for the issue of Commercial Paper (CP) and subsequently by SEBI, when it made credit rating compulsory for certain categories of debentures and debt instruments. In June 1994, RBI made it mandatory for Non-Banking Financial Companies (NBFCs) to be rated. Credit rating is optional for Public Sector Undertakings (PSUs) bonds and privately placed non-convertible debentures up to Rs. 50 million. Fixed deposits of manufacturing companies also come under the purview of optional credit rating. A corporate credit rating is an independent evaluation of a firm’s ability to make debt payment in a timely fashion. A credit rating may be assigned to a particular debt issue, or it may include the general ability of the firm to meet its obligations. When issuing a credit rating the rating agencies incorporate quantitative and qualitative information obtained from public and the private sources. The agency’s analysis then produces a credit rating that represents the current opinion of the agency regarding the credit worthiness of an obligatory.

Credit ratings make information about default likelihoods and recovery rates of a security widely available, limiting duplication of effort in financial markets. They allow uninformed investors to quickly assess the broad risk factors of tens of thousands of individual securities using a single
and well-known scale. In addition, ratings are relied on extensively in regulation and private contracting, and as a tool for measuring and limiting risk. Credit rating lays emphasis on both financial and non-financial factors, the academic literature has focused primarily on the awareness and attitude of investors towards credit rating\(^1\). This study extends the analysis of investor’s awareness on rating symbols, rating methodology, rating mechanism and how far they believe the ratings while taking their investment decisions. This study mainly focuses on the investor’s behavior towards ratings assigned by the rating agencies in India.

Credit rating agencies are one of the most powerful organizations in capitalist countries and central to the world’s global financial system. The lower their ratings of bonds issued by governments, financial institutions and corporations, the greater the probability the issuer will default. The greater risk is reflected in a higher interest rate, which acts as an added attraction to potential buyers and, conversely, as a penalty to the issuers. Given their effect on global financial markets, CRAs are one of the most important examples of the growing privatization of public authority in the global political economy\(^2\).

### 1.2 IMPORTANCE OF THE STUDY

Credit Rating is given to caution investors as about the risk associated with the investment portfolio as well as assure the probability of getting back their amount of investment. The ratings are opinions provided by the

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issuer based on publicly available and non-public documents of companies. The credit rating plays a pivotal role in protecting the interest of investor by guiding them towards the right path.

The high volatility in the capital market and scams has diluted the buoyancy of Indian investors in corporate securities. At this juncture, credit rating is significantly useful to investors when they choose appropriate investment options from the spectrum of investment avenues. Therefore, considering the imperative of credit ratings, the different facets of credit rating are required to be studied in an in-depth manner. Hence, this study aims at providing the vital inputs to the credit rating agencies in India in order to understand and comprehend the investors’ attitude in the rapidly changing current scenario. So, this study analyses the investors’ perception regarding the performance of credit rating agencies.

1.3 STATEMENT OF THE PROBLEM

Credit rating agencies are responsible for analyzing the credit quality of various issuers and assigning a rating to these issuers’ obligations that corresponds to their perceived degree of credit risk. Associated with each rating, or ‘risk bucket’ is a likelihood of default that is derived from historical observations of the default behavior of companies within each rating class. As such published ratings clearly contain significant information concerning the quality and marketability of various fixed income issues. It is noted that credit ratings are considered a primary source of investor information in investment decision-making.

In India, six primary agencies such as CRISIL, ICRA, CARE, FITCH, ONICRA and BRW provide such credit ratings to the investors. The
importance of the services of these agencies in the Indian debt market cannot
be underestimated, especially considering the noteworthy growth in the past
decade in the number of Indian companies raising funds through long-term
borrowings, which was accompanied by the growth in the volume of trade of
debt instruments in secondary markets in India. Their role becomes doubly
important after taking into consideration the Indian financial markets’
inefficiency, much like that of most developing countries, as information
relevant to determining creditworthiness may not be publicly available.

The credit risk history of India displays a quality of instability, with
major changes in credit risk occurring within a few years of one another. In
such a climate, the role of the credit rating agency becomes increasingly
important as a source of current information concerning the creditworthiness
of the corporate under watch. Recently, credit rating agencies have come
under sharp criticism for failing to respond to events and downgrade suspect
companies with sufficient speed.

Worldwide, investors are rigorously watching withdrawals of rating
or downward rating, as it cautions the investors. But Indian investors do not
give prime importance to the credit ratings because lack of financial literacy.
A significant chunk of investors do not know how to correctly interpret and
analyze the information contained in public financial statements and the
reliability of credit ratings. Hence, it is worthwhile to identify the factors
affecting investment decisions of investors and to find out the extent to
which credit ratings affect their investment decisions. So, the present study
has made a sincere attempt to analyse the investors’ attitude towards
performance of credit rating agencies. In this regard, the following research questions are probed.

i) What is the level of awareness among the investors with respect to credit ratings?
ii) What is the attitude of investors towards rating mechanism and rating methodologies of credit rating agencies in India?
iii) Do these factors lead to performance of credit rating agencies with respect to investors’ concern?
iv) What is the level of satisfaction with the performance of credit rating agencies?

1.4 OBJECTIVES OF THE STUDY

The study has been carried out with the following objectives:

i) To study the progress of credit rating agencies in India;
ii) To analyse the perception of investors towards the performance of credit rating agencies;
iii) To examine the investors’ attitude towards performance of credit rating agencies;
iv) To examine the influence of demographic profile of investors on assessing the performance of credit rating agencies;
v) To identify the problems encountered by the investors with respect to credit ratings; and
vi) To offer valid suggestions for the betterment of rating mechanism of credit rating agencies.
1.5 RESEARCH METHODOLOGY

Survey method has been followed for the study. Both primary and secondary sources of data are used. A well structured questionnaire has been designed to elicit necessary data and details from the investors about the performance of credit rating agencies. The secondary data have been collected from the books, journals, magazines and web portals.

1.5.1 Pilot Study

A pilot study was carried out with a questionnaire to analyse the performance of credit rating agencies. The questionnaire was circulated to 75 investors. The data collected in this process was tested using Cronbach’s Alpha for its reliability. The result of the testing and validation revealed that the questionnaire possessed the reliability with the value of 0.763. It was further ascertained that the Hotelling T Square value is 965.170 which is statistically significant at 5% level. The questionnaire is best fitted in a normal distribution which indicates that the questionnaire used for pilot study is highly suitable in ascertaining the responses from the investors. Based on the experience gained in the pilot study, the questionnaire was suitably restructured to be administered for the study.

1.5.2 Sources of Data Collection

➢ Primary Data

The primary data was collected with the help of a well structured questionnaire which was administered for this purpose.
Secondary Data

The secondary data was collected from various published and unpublished research reports, textbooks, magazines, journals and dailies, internet resources, other published and unpublished sources of information.

1.5.3 Questionnaire

The primary data was collected through well-structured questionnaire comprising bi-polar, optional type, and Likert’s 5 point scale type questions. The questionnaire included questions regarding demographic profile of the investors, investment pattern of the investors, investors’ awareness towards credit ratings, investors’ attitude towards the performance of credit rating agencies, problems faced by the investors in credit ratings and suggestions for betterment of performance of credit rating agencies.

1.5.4 Sampling Design

The researcher has adopted multi-stage sampling to collect various perceptions of investors with regard to the performance of credit rating agencies. In the first stage, out of the 32 districts of Tamil nadu, two districts have been selected as Erode district is one of the important leading business centre as well as Coimbatore district is a well known flourishing industrial district. In the second stage, a proportionate random sampling method has been employed to select the sample investors. Erode and Coimbatore districts consist of 2 revenue divisions each with a significant dense population. 500 investors have been chosen proportionately covering all the revenue divisions (4 X 125 = 500) of Erode and Coimbatore districts. In the
third stage, snowball sampling method has been used to select all categories of investors such as businessmen, government employees, private employees, professionals and agriculturists. Out of the 500 sample investors, only 480 responses have been found suitable for analysis. Hence, the exact sample size of the study has been restricted to 480 (Table 1.1).

### Table 1.1
**Sample Size**

<table>
<thead>
<tr>
<th>S.No.</th>
<th>District</th>
<th>Revenue Division</th>
<th>Sample</th>
<th>Non Response</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Erode</td>
<td>Erode</td>
<td>125</td>
<td>2</td>
<td>123</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Gobichettipalayam</td>
<td>125</td>
<td>4</td>
<td>121</td>
</tr>
<tr>
<td>2</td>
<td>Coimbatore</td>
<td>Coimbatore</td>
<td>125</td>
<td>5</td>
<td>120</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Pollachi</td>
<td>125</td>
<td>9</td>
<td>116</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td></td>
<td><strong>500</strong></td>
<td><strong>20</strong></td>
<td><strong>480</strong></td>
</tr>
</tbody>
</table>

**1.5.5 Analytical Framework:**

The data collected were organised as simple tables and further analysed with the help of appropriate statistical tools such as- Descriptive statistics used to analyse the optional type questions relating to demographic profile, investment pattern of the investors and awareness towards credit rating agencies. Parametric One sample ‘t’ test was applied to analyse each of the statements using Likert’s Five point scale to test their significance. Factor analysis by Principal Component Method was applied to identify the contributory factors that led to the investor’s perception on credit rating agencies and performance of credit rating agencies. K- Means Cluster Analysis was applied to classify the investors based on factor perception and Discriminant analysis was applied to justify the cluster perception.
Friedman’s test (Non parametric) was used to identify the prime factors influencing the investors’ perception on CRAs. Multiple Regression, Mean Score and Parametric One way ANOVA were applied to identify the factors influencing the investors’ perception about the performance of credit rating agencies. Apart Karl Pearson’s Coefficient of Correlation and Non-Parametric Chi Square test was applied to measure the various clusters of performance of credit rating agencies and demographic profile of investments and their investment pattern.

1.6 SCOPE OF THE STUDY

The purpose of this study is to analyse the investors’ perception towards credit rating agencies which includes a thorough analysis of investors’ awareness on credit rating agencies and investors’ attitude towards performance of credit rating agencies. The outcome of this study will be of immense help to the rating agencies in understanding the investors’ perception, to frame appropriate mechanism for avoiding fluctuations in the ratings and adopt an appropriate strategy to serve stakeholders in the capital market.

1.7 HYPOTHESES OF THE STUDY

Based on the objectives of the study the following hypotheses are framed:

i) There is no association between demographic profile of the investors and their awareness on credit ratings;
ii) There is no association between demographic profile of the investors and their satisfaction towards performance of credit rating agencies.

1.8 LIMITATIONS OF THE STUDY

It is natural that any research investigation suffers from certain limitations, which warrant an attitude of caution and healthy criticism about its findings. The limitations of the study are,

✦ The research area of the study is strictly confined to Erode and Coimbatore districts.
✦ The investors are widely scattered in the study area. So the selection of sample, however done scientifically, may not represent the entire universe.
✦ Money and time constraints have imposed major limitations to the study and forced to restrict the number of investors within a stipulated time.
✦ The information provided by the investors is purely based on their perception only. The quality and reliability of the data collected is the actual expression of investors.
✦ The suggestions offered in this study remain restricted to the micro study of the investors’ plight alone and might smack of remedies rather than solutions or alternatives.
1.9 CHAPTER SCHEME

The entire thesis has been presented in six chapters, the description of which is enumerated hereunder:

- The First Chapter deals with the introduction and design of the study.
- The Second Chapter presents a review of related literature available in this field.
- The Third Chapter presents Profile of credit rating agencies in India.
- The Fourth Chapter presents profile of the study area and the analyse of investors’ perception on credit ratings.
- The Fifth Chapter describes the investors’ attitude towards performance of credit rating agencies.
- The Sixth Chapter recapitulates the key findings, suggestions, conclusion and the scope for further research.