CREDIT RATINGS AGENCIES

CHINTALURI LAKSHMI KARTHEEK*,MANMOHAN TIWARI**

PG SCHOLAR*, ASSISTANT PROFESSOR**

DEPARTMENT OF MBA, SWARNA BHARATHI INSTITUTE OF SCIENCE & TECHNOLOGY, KHAMMAM

ABSTRACT: Credit rating agencies (CRAs) plays a crucial role in financial markets for lenders, investors and issuers in reducing information asymmetry between different parties. Credit rating helps us to know about the credit capability of individuals in a country. When all the investors are positively rated, then there will be an increase in new startups. Gradually income of the country increases, Employment opportunities expands and Poverty ranks less. When there is development in all the sectors then the GDP increases and country develops. The paper clearly explains the part played by credit rating agencies in the development of a country either directly or indirectly. The objective is to study about the importance of credit rating   for a country to develop. Analytical research as well as descriptive type of research is used for the study. Secondary as well as primary data has been gathered for the study. The sources for the data are through the websites of the rating agencies, journals, newspapers and banks. Banks helps in knowing the investment status of the country. The study briefly explains the steps which lead to country's development. This helps in knowing the economies standard of living and development. The study describes, considering what points and how a country gets developed. The study discussed the objectives of research, hypothesis formulated, definition of the basic terms, assumptions and limitations. The study helps us to know the financial position of the country and part played by different sectors in the progress of the nation.

KEYWORDS:Credit rating, Credit rating agencies, banks, services, GDP, development.

1. INTRODUCTION

Service sector is an important sectors that majorly contributing to country's development. Credit rating comes under financial services, as it provides financial security with their ratings. Presently, credit rating represents one of the most significant financial issues due to the recent economic crises. The role and importance of credit rating agencies have increased in the recent years.

Definition Credit Rating

Credit rating refers to knowing the credit assess ability of customers that means knowing the credit repayment history of the customer. Credit rating is used by all the customers who would like to seek loan facilities.

Credit Rating Agencies

Credit rating constitutes an opinion of a rating agency that evaluates the basic credit strength of any customer and his capability to fully and on time meet his debt commitments. Credit Rating specifies the credit praiseworthiness of the borrowers and the possibility of the borrowers will pay back the interest and principal on payable dates.

Origin of Credit Rating Agencies

The journey of Credit Rating Agency started from 1841 by Lewis Tappan in New York City. It was then gained by Robert Dun, who published its first ratings guide in 1859. Another early agency, John

Bradstreet, started in 1849 and published a ratings guide in 1857. Credit rating agencies took birth in the United States in the early 1900s, when ratings began to be practical to securities, exclusively those related to the railroad bond market. In the United States, the construction of wide-ranging railroad systems had lead to the enlargement of corporate bond issues to finance them, and consequently a bond market several times superior than in other countries. Following the 1907 financial crisis, demand started increasing for the autonomous market information, in particular for independent analyses of bond creditworthiness. In 1909, financial analyst John Moody issued a publication focused solely on railroad bonds. His ratings are the first one to be published extensively in an easy to get to format, and in fact his company was the first one to charge subscription fees to investors.

OBJECTIVES OF THE STUDY

➢ The main objective of the study is to render a certainly friendly third party opinion on the potentiality and creditworthiness of the customers.
➢ To create knowledge amongst customers about the extent to which their payment history affects their credit score.
➢ To know how Credit Rating helps in a country's development
➢ To study the main part played by credit rating agencies in developing a country.
➢ To provide them a chance to improve & increase their organizational strengths, opportunities and Credit worthiness, by which they can outpour credit at a very cheaper rates and on easy ways.

NEED AND IMPORTANCE OF THE STUDY

➢ Credit Rating Agencies play a major role in country's overall development.
➢ Credit rating agencies primary role is to reduce information asymmetry in credit markets by providing customers an opinion on the capability.
➢ Banks need to select best credit rating agency to get accurate information about customers.
➢ It also helps the distributers of the debt instruments to price their issues in the approved manner and to reach out to innovative investors.
➢ It helps investors in launching new business which in turn develops country's income.
➢ The main importance of the study is to know the roles played by credit rating agencies for a country to develop in all the sectors.

2. SCOPE OF THE STUDY

The scope explains the theoretical aspects of credit rating in developing a country. The study has been carried on the efficiency of credit rating agencies. The study considered the steps which lead to country's development in which GDP has been considered as a symbol of development. GDP shows the development of any country.

3. RESEARCH METHODOLOGY

Both analytical research and descriptive research were used in analyzing the objective of the study. Analytical research represents the investigative and organized study using the facts which are already available to come to a conclusion. Descriptive research represents expressive and graphical representation of the data for analyzing and representing the result for the study.

4. SOURCES OF DATA

Primary data: Data gathered by personal communications with the people of credit rating agencies.

Secondary data: Data from websites, newspapers, journals, books, credit rating agencies is used for the study.

Tools and Techniques: Tools and techniques used for the study are tables, line graphs and pie charts.

Hypothesis

- H0: There is no significant influence of credit rating agencies on service sector GDP.
- H1: There is significant influence of credit rating agencies on service sector GDP.
- H0: There is no significant influence of credit rating agencies in India's development.
- H1: There is significant influence of credit rating agencies in India's development

Service sector GDP represents the contributions of Service sector towards GDP. As Credit Rating is a part of financial services, so it has been considered for the study.

5. REVIEW OF LITERATURE

- Frank Partnoy (2017) this article discusses about three problems which are been faced by credit rating agencies because of congress government. The author proposed suggestions for these problems in this article. Author strongly put pressure on the ongoing problem faced by both the parties i.e., rating agencies and investors. The theme of credit rating is missing because of the methodologies which are followed by the rating agencies. He even pointed out the problem of unwarranted and mechanistic reliance with credit ratings. He observed the lack of oversight of credit rating agencies and suggested some regulatory reforms for this problem. He addressed about the methodologies and different types of risks of corporate.

- Patrick Bolton, Xavier Freixas and Joel Shapiro (2012) Authors talks about the competition among credit rating agencies which was expected to reduce the efficiency of market with help of a model. They explained about the features of credit rating agencies in brief. Author's organized the study in the form of sections explaining the comparison and expansion of credit rating agencies. They also made some assumptions indicating about the information on investment. They explained the study by examining the game with monopoly credit rating agencies. They explained the competition among credit rating agencies and their empirical implications.

- Timothy E. Lynch (2009) Author specified the fundamentals of credit rating agencies and the important role played by credit rating agencies for the information flow for investment. Author evaluated the role of credit rating agencies in the capital market and investment policy. He explained about the usage of credit rating information by private contracting parties. He even specified about the problematic issues which are been presented by credit rating agencies. He argued about the integrity defences of credit rating agencies. Thereare many problems with the current regulatory environment which are evaluated in the study.Finally author has highlighted the significance of the credit rating industry in capital market and the problems faced in the credit rating industry under the current regulatory regime. He even brought to light the problems with the issuer- pays conflict of interest.

- Abdullah Ash-shu'ayree Al-khawaldeh (2013) Authors reviewed many papers and evaluated the hypothesis by using the statistical tools like regression analysis. According to the study there is no empirical evidence of whether it is based on bivariate or multivariate analysis, which supported the relationship between the Jordanian listed company's capital intensity and credit rating. The study identified the fixed assets level as relatively small. Authors concluded the research confirming the different techniques using credit rating internal data models for the analysis which results that some variable have a significant impact on credit ratings. The results of the study specifies even the size and growth potential are associated with positively strongly credit ratings.

- Omaima. G. Hassan and Ray Barrell (2013) Author analysis the study and examines the problem of, to what extent banks ratings reflect banks and the characteristics explains the accounting information to determine the problem. Author explained the study using descriptive research by taking the samples of US and UK. Statistical tools like correlation matrix and regression results are used to evaluate the study. The results revealed the performance of the model which helped 74% to 78% of banks in assigning correct credit ratings. There was a difference of assigning ratings to the banks, as highest rated banks and lowest rated banks.

- Marwan Elkhoury (2008); Author discussed about the information gap in the international financial system. Using qualitative and quantitative methods as procedures and methods for evaluation. Author elaborated the methodology profile of Standard and Poor. The determinants of credit ratings explain both the mature and emerging markets. Author discussed about the two other various independently. They are increased in international interest rates and the exports structure. He discussed about the shortcomings which arise out of regulatory initiative. Credit rating agencies analyze many factors for assigning rating, that factors have been discussed in the study.The review of literature represents the author's opinion about the credit rating agencies. This review helped my study to understand the methodologies which are followed by credit rating agencies and the problems which are been discussed in the review helped me to study further.

Benefits of Credit Rating Agencies

Credit ratings are a considerable gadget for borrowers to get admission to loans and debt. When investors have good credit history then their credit rating score will have no objection. Credit ratings help investors to effortlessly borrow money from financial institutions or public debt markets. At customer level generally banks, base the terms of a loan as a main task of the credit rating, so with this the better the credit score, the better the terms of the loan typically are. If the credit score is poor, the bank may even reject the loan. As this is the base for granting of loans. When loans are approved for investors then they start new business by which employment increases, increasing incomes of individuals. Growth is possible when all the sectors develop. When one sector is developed the result will play a part for the development of another sector.

Assuming the Steps which Lead to Country's Development

- Positive credit history
- Credit rating agencies positive credit score
- Issue of loans
- Investment into new business
- Increase employment opportunities
- Income increases
- Better standard of living
- Demands more products
- Leads to increase in supply levels
- Prices decreases
- Inflation increases
- Effects GDP
- Country develops

Figure representing the steps which lead to country's development:
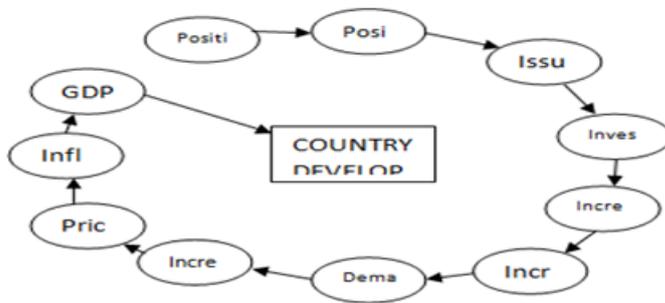
The figure represents the steps which help in country's development and how each sector is depending on another. When one sector is developed the result will help another sector to develop which leads to total country's development.

6. DATA ANALYSIS AND INTERPRETATION

Table 1: Tabular Representation of GDP of India from 1980- 1990

| Year	Gross domestic product, constant prices
1980	5.281
1981	6.006
1982	3.476
1983	7.289
1984	3.821
1985	5.254
1986	4.777
1987	3.965
1988	9.628
1989	5.947
1990	5.534
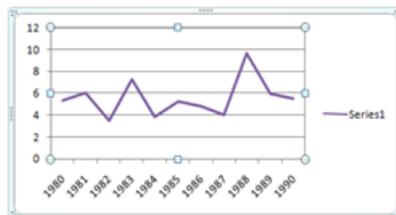
Graph 1: Graphical Representation of GDP of India from 1980-1990

Interpretation

It is clearly observed in the graph that there are fluctuations in the GDP, whatever the reason maybe, whether the decrease may be due to other sectors. As compared from 1980-1990 the GDP has very little increased, showing a positive indication of development of economy.

Table 2: Tabular Representation of GDP of India from 1991- 2000

| Year	Gross domestic product, constant prices
1991	1.057
1992	5.482
1993	4.75
1994	6.659
1995	7.575
1996	7.55
1997	4.05
1998	6.184
1999	8.463
2000	3.975
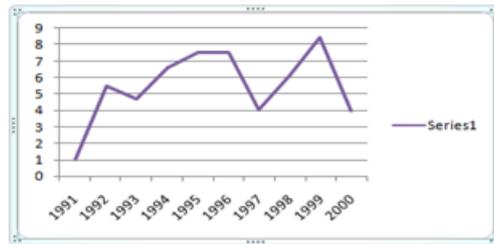
Graph 2: Graphical Representation of India's GDP from 1991-2000

Interpretation

We can clearly identify the huge changes in the GDP. At a certain point it even reached 8 but gradually decreased in 2000. But comparing the years 1991-2000 there is a slight increase in the GDP. But many changes took place in between these ten years.

Table 3: Tabular Representation of GDP of India from 2001-2010

| Year	Gross domestic product, constant prices
2001	4.944
2002	3.907
2003	7.944
2004	7.849
2005	9.285
2006	9.264
2007	9.801
2008	3.891
2009	8.48
2010	10.26
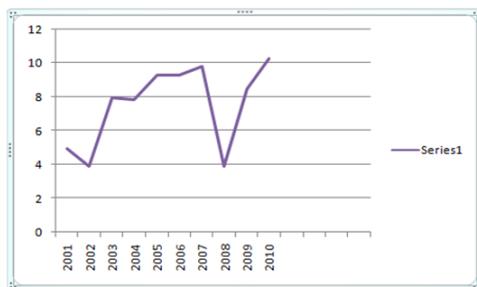
Graph 3: Graphical Representation of India's GDP from 2001- 2010

Interpretation

Even in this graph there is bit more changes in the GDP. At a certain stage a huge rate has been noticed that is 9.8 in 2007 and slowly decreased and then increased and reached 10 in 2010 which is a positive indication of country's development.

Table 4: Tabular Representation of GDP of India from 2011-2017

Year	Gross domestic product, constant prices
2011	6.638
2012	5.081
2013	6.899
2014	7.168
2015	7.93
2016	7.11
2017	6.7
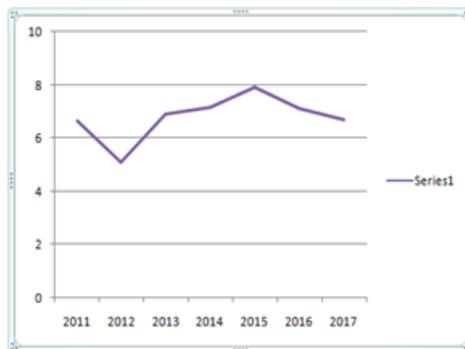
Graph 4: Graphical Representation of GDP of India from 2011-2017

Interpretation

There are fluctuations which took place in these years which started at 6.6 in 2011 and at a certain year it reached 7.9 in 2015 and then decreased to 6.7 in 2017. There is a slight change in GDP but this is also showing a positive hope of GDP to increase in upcoming years.
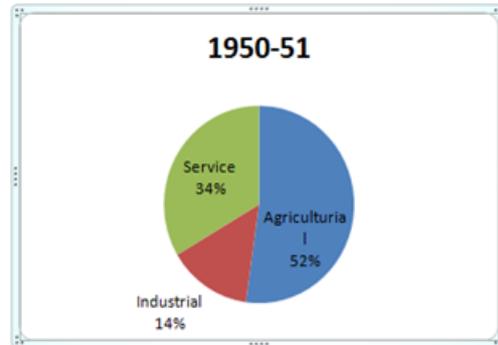
There are Different Sectors which Majorly Contribute to GDP. They are:

- Agriculture sector

- Industrial sector

- Service sector

Contribution of Different Sectors to GDP:

Table 5: Tabular Representation of Different Sectors Contribution towards GDP in 1951-52

| Sectors	Year 1950-51
Agricultural	51.81
Industrial	14.16
Service	33.25

1950-51

Graph 5: Graphical Representation of Different Sectors Contribution towards GDP in 1951-52

Interpretation

In 1950-51 the priority was given much to agriculture sector as it is the main occupation of our country, whereas service sector contributes only 34% towards GDP. It may be due to lack of knowledge about modern technology and usage of traditional methods and techniques.

Table 6: Tabular representation of different sectors contribution to GDP in 2016-17:

Sectors	Year 2016-17
Agricultural	17.32
Industrial	29.02
Service	53.66
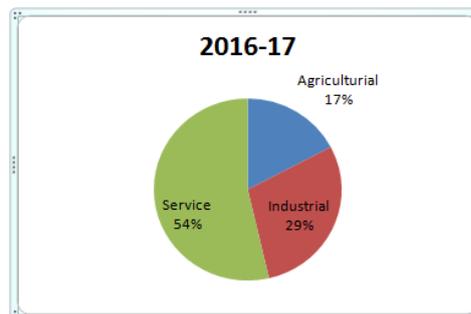
2016-17

Graph 6: Graphical Representation of Different Sectors Contribution to GDP in 2016-17

Interpretation

We can see a drastic change in service sector contribution; it is almost 54% of the total GDP. There are many reasons for the expansion. They are discussed in brief in this paper. More than half of the GDP share is from service sector. This shows the development of the country.

Roles of Credit Rating Agencies towards Country's Development

➢ Credit rating agencies estimate the relative credit risk of specific debt securities or structured finance instruments and borrowing entities.
➢ The creditworthiness of governments and their securities.
➢ Serves as information intermediaries connecting banks and customers.
➢ CRAs tentatively lessen information costs.
➢ Increase the collection of praiseworthy or prospective borrowers.
➢ Promote liquid markets.
➢ These functions may add to the contribution of accessible risk capital in the market and support economic growth.

General Factors which Effect Credit Scoring

➢ The agency takes into account the individuals past credit history of borrowing and repayment of debts. If any payments are missed or defaults on loans impact the ratings negatively.
➢ The agency also observes the businesses potential economic capability. If the economic potential seems bright, the credit score tends to be higher; if the borrower does not have a positive economic outlook, the credit rating will decrease.
➢ The credit rating is carried to individuals by source of a numerical credit score that is maintained by Equifax, Experian, and other credit-reporting agencies. A positive credit score ranging from 700-900 specifies a stronger credit summary and will generally result in lower interest rates exciting the lenders.
➢ There are a many factors that are taken into consideration for estimating an individual's credit score including payment history, amounts to be repaid, and length of credit history, new credit, and types of credit. Some of these factors have superior weight than others. Details on each credit issue can be found in a credit report that which explains about a credit score.

LIMITATIONS OF THE STUDY

➢ The prevailing manual credit risk management systems are quite expensive and very difficult to maintain.
➢ The cost that is involved in maintaining the qualified, experienced and trained credit rating executives is very high.
➢ It is not possible for different types of investors to come to a common ending as to the qualified quality of the instrument. Moreover they do not ensure the requirement skills of credit estimation.
➢ As the data used for the study is secondary data. It may be lacking in accuracy, or they may not be completely latest or reliable.
➢ The study considered only GDP for analyzing country's development.

HYPOTHESIS

Evaluation Of Hypothesis

➢ The analysis clearly gives information that there is significant influence of credit rating agencies on service sector GDP
➢ There is significant influence of credit rating agencies in India's development which has been indirectly explained with the figures and in data analysis.
➢ Development is not directly possible in service sector; there are many points to be considered which the study evaluated in brief.

CONCLUSION

➢ When the credit history of the investors is good then their credit score would be better and positive. Therefore getting loans becomes very easy.
➢ When loans are approved investors can invest in different businesses increasing employment.
➢ The development of a country depends on GDP of that country.
➢ As per the study the GDP shows a positive increase which represents the development of the country.
➢ If all the sectors develop then the development of the country is very easy.

REFERENCES

➢ Ash-shu A., Determinants and Impacts of Internal Credit Rating, International Journal of Financial Research 4(1) (2013), 120-131.
➢ Bai L., On regulating conflicts of interest in the credit rating industry, NYUJ Legis. & Pub. Pol'y 13 (2010).
➢ Evans C., What Makes You So Special?: Ending the Credit Rating Agencies, Special Status and Access to Confidential Information, Val. U. L. Rev. 46 (2011).
➢ Hill C.A., Why Did Rating Agencies Do Such a Bad Job Rating Subprime Securities?, University of Pittsburgh Law Review 71 (2010).
➢ Partnoy F., what's (still) wrong with credit ratings?, Washington law review 92 (2017).
➢ Elkhoury M., Credit rating agencies and their potential impact on developing countries, Discussion paper no.186 (2008).
➢ Hassan O.G., Barrell R., Accounting for the determinants of banks' credit ratings, Economics and finance working paper series (2013).
➢ Bolton P., Freixas X., Shapiro J., The credit ratings game, The Journal of Finance 67(1) (2012), 85-111.
➢ Cantor R., Packer F., Differences of opinion and selection bias in the credit rating industry, Journal of banking and finance 21(10) (1997).
➢ Lynch T.E., Deeply Persistently Conflicted: Credit Rating Agencies in the Current Regulatory Environment, Case Western Reserve Law Review 59 (2009).