EFFICACY OF CREDIT RATING PROCESS IN INDIA

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Abstract

The value of ratings assigned by credit rating agencies (CRAs) is a widely debated topic, especially in the aftermath of the global financial crisis of 2008. The CRAs remain a vital mechanism of the financial system with significant importance to debt issuers, investors and regulatory agencies. The question of whether rating changes bring new information to financial markets, and to what extent is still unresolved in the literature. The dissertation explores this question using data from India and also analyses the impact of the regulatory disclosure requirements on credit rating process.

The first essay examines the value addition by CRAs in Indian financial market using a sample of long-term rating changes during the period 1996-2015. By reviewing security price reactions to the announcement of rating changes, the study finds evidence of significant negative market reaction subsequent to rating downgrades and upgrades. This suggests that credit ratings add value to the financial market. The market reaction is more pronounced for rating changes of market-based instruments as compared to bank-based instruments. The negative market reaction is predominant for firms in the investment-rating category, and the market consistently values the rating announcements from CRISIL compared to ICRA and CARE, which are the leading players in the market. The magnitude of the adverse reaction is lower in the post-crisis period suggesting that the incremental value addition by rating agencies has reduced after the crisis.

The second essay analyses the impact of a regulatory disclosure norm on credit rating using data from India. The Securities and Exchange Board of India (SEBI) issued Transparency and Disclosure (T&D) Norms in June 2010 to impart higher credibility to the processes.

The third essay examines the relative importance of various accounting variables that are used to determine the credit rating issued by CRISIL for the debt instruments of Indian firms. The firm size as specified by market capitalization, stock beta, and volatility are also modelled as determinants of credit rating. The ordered probit model analysis of a panel of firms with the most recent rating change announced by CRISIL indicates that interest coverage, profitability, and financial leverage, as well as market size, stock beta, and volatility, have a significant effect on credit ratings. We find evidence that the credit rating levels have become lower after the passage of T&D Norms by SEBI in June 2010. The results show that credit rating agencies give lower ratings for the same accounting variables post 2010 suggesting that regulations and disclosure requirements influence rating agencies to be conservative in their rating standards.