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RETAIL INVESTORS' PERCEPTION TOWARDS CREDIT RATING AGENCIES AFTER IL&FS CRISIS - A STUDY

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Abstract

In India, over the years, credit rating agencies (CRAs) have played a predominant role by giving rating to investment bonds and shares, considering the default risk of the respective financial instruments, thus helping investors and companies. But the credibility of these agencies has been eroded among retail investors due to various incidents like satyam fiasco, subprime crisis, recently IL&FS and many more such incidents. In this present scenario, the present study was conducted to find out the investors' perception about credit rating and measures taken by SEBI to build confidence among investors. For the present study, retail investors of Hyderabad were considered and primary data were gathered through a questionnaire, related to investor perception of CRAs. The study results, as expected, had shown that the perception of investors, relating to the functioning of CRAs, was not positive and the trust it had built over the years, had decreased, with the outbreak of IL&FS crisis..

Keywords: *Rating Shopping, Financial Instruments and Credit Rating*

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1. Introduction

Credit rating agencies provide valuable service to the investors, by rating countries, business entities and various other marketable financial instruments, for which the investors do not have knowledge about its operations and performance, thus helping informed investment decision. These are professionally managed firms, who have access to primary information about the companies and industry activities. Their job is to analyse the information given by an enterprise and see if they can repay the amount they plan to borrow. Through its rating, they provide a better perspective to the investors, whether it is a good instrument to invest **(Suzana Baresa, 2012).** The market regulator SEBI has made it mandatory for the firms, which have listed their shares and for new issuer of shares, to rate their shares/bonds/debentures with any of the CRAs, thus making it easy to understand about any marketable financial instruments and to assess its value in the market. The revenue model for CRAs is a 'issuer-pay model', which means that the issuers pay money and provide data to analyse and rate their companies' bonds/ shares. CRAs provide impetus to the growth of financial market and thus helping investors and the companies in the form of providing investment alternatives and required finance to the companies. In short,CRAs help the financial markets to grow in India.

According to BIS (Bank of International Settlements), there are around 130-150 CRAs operating in various parts of the world, providing sector wise services in a particular geographical area. Out of these rating agencies, Standard and Poor's, Moody's and Fitch Ratings alone cover 90% of the market. The six credit rating agencies in India are **CRISIL (1988), ICRA (1991), CARE (1993), SMERA, Ind-Ra (1996), Brickwork ratings (2008).** These CRAs in India provide low cost information to the investors, in the form of gathering, anlayzing, interpreting and evaluating complex data correctly and translate them in a concise and easily understandable way. Through its rating, it provides to an investor a basis for analysing risk and return of shares and bonds, in which they plan to invest. With its highly trained professional staff and with access to superior information at various firms, they provide inputs for decision making to investors. They also help companies, by providing better rating, thus enhancing their corporate image.

2. Review of Literature

Saha, (2010)and**Devi, (2014)** in their study on, 'Credit rating – an Important Tool for Investors Decision making', explain the important role played by CRAs, in guiding and helping investors to take wise investment decisions and helping corporates to get funds for their investment. According to their study, credit rating is a guidepost to lay investors and helps the savings of households to be channelized into corporate investment. **Reddy(2010),** in the study, 'Some Aspects of Credit Rating: a Case Study', concluded that credit rating services play a crucial role in the growth of Indian economy, by acting as a information provider, thus helping investors in the determination of investment portfolio.

The results of the study on four nationally recognised CRAs, revealed that institutional investors and issuers differed in their assessment of CRAs, relating to timely rating and credit worthiness (**H. Kent Baker, 2001**)**(Sattar Mansi, 2001). Suveera Gill (2005)** studied ICRA rating, to examine the reliability of rating on the basis of actual default rate experience, on long term debt, across five sectors over a period of seven years between 1995-2002. The study was conducted on the bonds, that were accepted and issued and the default ratings were examined institution wise, sector wise and period wise. The findings revealed that the ICRAs performance, in terms of surveillance, provision of timely and complete information about the companies, was not up to the mark. In other words, excessive reliance on the rating given by CRAs,could put investors' money at risk.

In a study by **CFA Institute (2014),**around 20,379 members of CFA Institute,throughout the world, were contacted through online survey. 67% of the respondents reported that investors have become wary of credit rating in their investment process. 62% of respondents recorded that CRAs, under issuers' pressure, inflated rating and only 27% of the respondents reported that reliability and quality of rating have improved since financial crisis, due to the measures taken by regulatory authorities. Almost 61% of the CFA members opined that change in the issuer pay model of CRAs functioning and increasing transparency of rating, should be established, to improve reliability. 60% of respondents found fault with the CRA business model and opined that increasing transparency and competition could provide the solution **(CFAInstitute, 2014).** In a study on "Indian Households' Investment Preferences, with special reference to Debt Market Instruments,based on the Third All India Household Investors' survey, it was found that 42% of overall respondents were not aware of credit rating and 66% of the respondents, who were aware, had reported very low confidence in the rating given by CRAs **(L C Gupta, 2001).** In a few other studies, conducted by researchers separately, had identified that CRAs are more liberal in their functioning, reactive in nature, internally inconsistent in nature **(Devi, 2014).**The above studies showed a mixed response as far as the customers' opinion on credit rating agencies was concerned. Majority of studies revealed that the functioning of credit rating agencies was not up to the mark. As a result, the investor confidence in the CRAs was not high, thus questioning the role of CRAs in the present circumstances.

3. Statement of the Problem

Though CRA's are very helpful to the investors and it has been made mandatory by the regulatory bodies for issue of shares, they failed the investors under quite a few issues since its inception. The Asian financial crises, **Enron debacle (2001), global financial crisis (2008),** are some cases where CRAs were not functioning satisfactorily **(Suzana Baresa, 2012)**. In the recent IL&FS crisis, RBI and SEBI had blasted CRAs, for allowing low rated companies, to do the "rating shopping". In its FRS report, CRAs' lax policies were found to be the cause for global financial crisis **(ETBureau, 2019)**. In September 2018, a fortnight before the IL&FS fiasco, Indian CRAs had given AAA/AA+ rating to its debt papers. CRAs continued to give the highest rating to IL&FS bonds even when subsidiary IL&FS transport networks had defaulted in June 2018. SEBI had observed in this case that CRAs had excessively relied on IL&FS management assertions. They had called it an act of 'rating shopping', which is an act of giving a better rating to a bond/financial instrument by another CRA, within 2 to 3 months of it getting a poor rating. The Regulator had acted swiftly upon their actions, by imposing a fine to the tune of 25 lakhs each to CARE and ICRA. Finance Minister reported that the Centre was in talks with CRAs, to assess their methods of risk evaluation and to know whether ratings match real world valuations, particularly in situations where the companies, with good rating, failed **(ETBreau, 2019)**. After the IL&FS crisis, ICRA and CARE had sacked their CEOs **(ETContributors, 2020)**.

Many market participants and commentators observed that CRA contributed to the 2008 financial crises. Hence increased regulations on CRAs with the introduction of Dodd-Frank Wall StreetReform and Consumer Protection Act 2010, in the USA**(IG.com, 2018).**The Indian market regulator, SEBI, had changed the regulations, governing CRAs, six times since 2016. Not relying on the CRAs' rating, investors in debt instruments are using additional screening mechanism, to assess the borrowers or the instruments they had invested **(ETBureau, 2019)**.

4. Need of the Study

In the light of the above series of events, which highlight the flaws in the working of the credit rating agencies in India and abroad and the declining customer confidence upon the rating given to various instruments by CRAs, the current research proposes to throw light on the investor perception (**Dharmaraj, 2019**)of the credit rating agencies and their functioning. The findings of the study would help the market regulator, to assess the functioning of CRAs and to further introduce measures to build the investor confidence upon the CRAs and thus boost the retail investment in financial instruments.

5. Objectives of the Study

The objectives of the proposed study were as follows:

1. To study the investors' perception of the CRAs,after the outbreak of IL&FS crisis.
2. To assess the impact of the confidence building measures, taken by the market regulator and government, on investor confidence.

6. Hypotheses of the Study

The following hypothetical statements were formulated and tested by the study.

NH-1: Investors' perception towards credit rating agencies performance is not positive.

NH-2: The perception of all retail investors regarding CRAs functioning is not one and the same.

7. Research Methodology

The present study was descriptive in nature and for the proposed study, the sample respondents were the retail investors of Hyderabad.Retail investors are non professional investors, who invest less than two lakhs of rupees in a particular stock and constitute major chunck in the Indian stock market.

7.1. Sample Selection

406 investors were contacted, through sources like stock brokers and other market participants. Snowball sampling technique was used, to collect data from respondents who were based in the City Hyderabad.

7.2. Sources of Data

For the proposed study, primary data were collected from retail investors, relating to their perception of CRA functioning and ratings. Further, secondary data were collected from periodicals, published journals and other websites.

7.3. Period of the Study

The data were collected during the period January – March 2020.

7.4. Tools used for the Study

A structured questionnaire was used, to collect the data from the sample respondents to measure retail investor perception. The questionnaire consisted of three parts. The first part was designed to gather, information relating to demographic profile of investors, awareness relating to rating and other information relating to CRAs and finally, questions relating to perception of retail investors relating to CRAs functioning and rating and the responses were structured by using Likert five point scale, with 5 as strongly agree and 1 as strongly disagree. The retail investors' perception, relating to the functioning of the CRAs, was ascertained by asking questioning relating to six factors like providing vital information for decision making, accurate rating (which can be relied upon by investors), being responsible for their actions, comprehensive while considering data to give rating, properly regulated by regulating authority like SEBI and change effects. Descriptive statistical tools were used to analyse the data. The outcome of the research would help the CRAs, to know where they stand with respect to their performance and their ability to gain investor's confidence,after the outbreak of IL&FS crisis.

8. Analysis on Investors Perception of the CRAs after the Outbreak of IL&FS Crisis

Primary data were collected from retail investors, for the study. According to the demographic profile of sample respondents,74% of respondents were male, 55% of them were graduates, 57% of retail investors were in the 41-50 age group, 52%were working in private sector, with a savings of 11-20% of their annual salary. The retail investors, on an average, were investing 1 – 2 lakhs of rupees in stocks and bonds, out of their total savings. As the respondents were retail investors in stocks and bonds, all the respondents were aware of the credit rating agencies, which were in the business of credit rating. 46% of investors reported that credit rating indicated credit risk of a firm. Among all the rating agencies, CRISIL is the most popular among retail investors. 56% of the retail investors opined that number of credit rating agencies in India is not enough and the ratings given by the agencies,were not useful to them (85%) and they were not comfortable with ratings given by various agencies (83%). 43% of retail investors were dissatisfied with the credit rating agencies' performance. Minority of respondents (23%) considered credit rating to help quick decisions while investing.

Table-1 shows the mean scores of various perceptual factors, among retail investors, on a five point scale, starting with 5 for strongly agree and 1 for strongly disagree. The mean scores of all the perceptual factors were less than 3, which implied that retail investors perceived that CRAs were not performing the work they were meant for and their confidence upon the CRAs was at its rock bottom,after the outbreak of IL&FS crisis. One sample t-test was conducted by testing sample mean with expected value of 3 (neutral) and the test results indicated that the null hypothesis cannot be accepted as p-value was less than 0.01. Hence **NH-1: The Investors perception towards credit rating agencies performance is not positive,** was rejected. In other words, retail investors' perception towards CRAs functioning was negative after the IL&FS crisis.

The **Table-2**reveals information about perceptual levels of retail investors,under different age groups, gender, educational qualifications and professions, towards CRAs' functioning. Almost all the retail investors either disagreed or remained neutral with respect to perceptual factors like vital information, accurate ranking, responsible, properly regulated, comprehensive and change effect. The chi square test,to identify the association between the categorical variables, with respect to the perceptual factors,indicated that there was association between the categorical variables, i.e., different age groups, gender, educational qualifications, professions, with respect to perceptual factors (as the p-value was less than 0.05). Hence **NH-2: The perception of all retail investors regarding CRAs functioning is not one and the same,** was rejected. In other words, almost all the retail investors, under various demographic profile (except for occupations accurate rating), perceived that CRAs failed with respect to providing vital information, giving accurate ranking, being responsible in their actions, properly regulated, comprehensive and being a change agent. As far as occupation vs accurate rating was concerned, retail investors, who were into business and worked for government service, did not completely disagree with other retail investors.

9. Findings of the Study

From the results, it is evident that almost all the retail investors were aware of the credit ratings and the meaning attached to various ratings. According to them, number of credit rating agencies in India was not enough and with the outbreak of IL&FS crisis, retail investors did not consider ratings to help them to take wise investment decisions.This finding differed from the findings of **Devi, 2014.**In short, majority of retail investors were dissatisfied with the CRAs and only a few considered credit rating for quick decisions.

From the above results, it is understood that retail investors'trust in credit rating agencies was shaken up by the recent incidents, including IL&FS. The image, which was built over the years through consistent results, was tarnished by the IL&FS crisis. Retail investors perceived that the CRAs did not provide timely information, which could help them in taking right decisions at the right time. This finding concurred, with the findings given by few other researchers **(Sattar Mansi, 2001) (CFAInstitute, 2014) (L C Gupta, 2001).** The CRAss did not enjoy the trust of retail investors anymore because they did not ensure safety of investment, by making them know about the financial position of the company and this statement agreed with the findings of **CFA Institute, 2014.** Retail investors were mistaken that the rating given by CRAs would be accurate and dependable. Majority of respondents did not believe that the CRAs were responsible, informative, transparent, not being corrupt and timely and hence credit rating agencies should restore the confidence of investors. Retail investors perceived that regulatory body, SEBI, did not play its role properly, by being a watch dog, and monitor, in the activities of CRAs. This had brought down the trust of the retail investors on CRAs and the system as a whole. As far as self regulation of the CRAs was concerned, the retail investors did not believe view that company review boards, the in-built responsibility mechanism of CRAs, were functioning properly, resulting in bringing down the trust of retail investors.

10. Suggestions

CRAs have to work more diligently, to see that incidents like IL&FS crisis,do not get repeated in the future, by being more disciplined and stringent in their actions. The functioning of CRAs has to be made more accountable and hence policy intervention is necessary to enable CRAs to be paid both by supplier and investor, thus making CRAs equally responsible to both parties. CRAs should be made accountable for their actions to regain the confidence of the investors. CRAs should be accountable for the losses to the investors, through their imprudent actions. The regulations governing the CRAs need to be modified and made more strict and transparent, so that CRAs would be responsible for their actions (in case if it is proved that rating shopping had taken place).

11. Conclusion

As the model of CRA is supplier paid, there is more chance of CRAs yielding to rating shopping, because it is a natural tendency to favour the one who had paid. This makes the whole mechanism of CRAs look biased. With the IL&FS crisis, it is proved that CRAs had completely lost the trust and confidence of retail investors. The Government,along with the regulatory body,should build a strong fool proof mechanism, to put a check on such incidents and rebuild confidence among the retail investors, who contribute large chunks of capital to the corporates through investments in stocks.

12. Limitations of the Study

The study had attempted to elicit the opinions of investors, from Hyderabad City of Telangana State. The sample could have been extended to other places of India, to elicit their opinions, about credit rating agencies.

13. Scope for Further Research

There are other areas,that can be explored like retail investors' attitude towards ratings, investors' behavior with change in rating, investor confidence with rating etc. There are certain other areas like percentage of companies refusing to share information with credit rating agencies, which had increased from 22% in FY 2018 to 47% in FY 2020. Thus CRAs are compelled to provide rating, based on inadequate information. **(Bureau, 2020).** Research in the above areas will fill the gaps in the area of customer perception towards credit rating.

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Table-1: Results of Mean scores of perceptual factors of retail investors

Perception factors	Mean	Std. Deviation	t-value	p-value
Vital Information	1.633	0.754	89.96	0.00**
Accurate Rating	1.542	0.755	92.30	0.00**
Responsible	2.108	0.341	170.61	0.00**
Properly Regulated	1.633	0.754	89.96	0.00**
Comprehensive	1.355	0.697	105.34	0.00**
Change Effects	1.135	0.566	137.68	0.00**

Source: Primary data computed and compiled using SPSS

- sig. at 1%, **Source: Primary data computed and compiled using SPSS

Table-2: Results of Perceptual Levels of Investors with Different Demographic Profiles

Demographic Vs Perception	Demographics	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Total	chi-square
Age Vs Vital Info	31-40 years	0	0	20	37	0	57	
	41-50 Years	4	24	93	107	0	228	
	51>	0	28	32	57	4	121	0.00
Age Vs Acc. Rating	31-40 years	0	0	12	36	9	57	
	41-50 Years	0	32	56	136	4	228	
	51>	0	20	61	40	0	121	0.00
Age Vs Responsible	31-40 years	0	0	8	41	8	57	
	41-50 Years	0	24	52	144	8	228	
	51>	0	8	40	69	4	121	0.00
Age Vs Properly reg	31-40 years	0	0	20	37	0	57	
	41-50 Years	4	24	93	107	0	228	
	51>	0	28	32	57	4	121	0.00

Table-2 contd.,

Demographic Vs Perception	Demographics	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Total	chi-square
AgeVsComprah	31-40 years	0	0	8	41	8	57	
	41-50 Years	0	24	52	144	8	228	
	51>	0	8	40	69	4	121	0.00
Age Vs Change effec	31-40 years	0	0	16	41	0	57	
	41-50 Years	0	0	56	148	24	228	
	51>	0	0	24	80	17	121	0.00
Gender Vs Vital Info	Male	4	40	117	135	4	300	
	Female	0	12	28	66	0	106	0.05
Gender Vs Acc. Rating	Male	0	40	84	163	13	300	
	Female	0	12	45	49	0	106	0.02
Gender Vs Responsible	Male	0	24	76	180	20	300	
	Female	0	8	24	74	0	106	0.02
Gender Vs Properly reg	Male	4	40	117	135	4	300	
	Female	0	12	28	66	0	106	0.01
Gender Vs Comprehensive	Male	0	24	76	180	20	300	
	Female	0	8	24	74	0	106	0.04
Gender Vs Change effect	Male	0	0	72	196	32	300	
	Female	0	0	24	73	9	106	0.02
Educational Qualification Vs Vital Information	Inter	4	12	20	37	0	73	
	UG	0	28	77	112	4	221	
	PG	0	12	48	52	0	112	0.00
Educational Qualification Vs Accurate Rating	Inter	0	8	40	25	0	73	
	UG	0	32	57	123	9	221	
	PG	0	12	32	64	4	112	0.00
Educational Qualification Vs Responsible	Inter	0	0	36	37	0	73	
	UG	0	20	44	153	4	221	
	PG	0	12	20	64	16	112	0.00
Educational Qualification. Vs Properly regulated	Inter	4	12	20	37	0	73	
	UG	0	28	77	112	4	221	
	PG	0	12	48	52	0	112	0.00
Educational Qualification Vs Comprehends	Inter	0	0	36	37	0	73	
	UG	0	20	44	153	4	221	
	PG	0	12	20	64	16	112	0.00

Table-2 contd.,

Demographic Vs Perception	Demographics	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Total	chi-square
Occupation Vs Vital Information	Private Employee	4	40	52	111	4	211	
	Professional	0	0	4	28	0	32	
	Govt. Service	0	8	32	24	0	64	
	Business	0	0	37	21	0	58	
	Others	0	4	20	17	0	41	0.04
Occupations Accurate Rating	Private Employee	0	36	77	89	9	211	
	Professional	0	0	8	24	0	32	
	Govt.	0	8	24	28	4	64	
	Business	0	0	12	46	0	58	
	Others	0	8	8	25	0	41	0.75
Occupation Vs Responsible	Private Employee	0	16	64	131	0	211	
	Professional	0	0	4	24	4	32	
	Govt.	0	8	16	36	4	64	
	Business	0	0	8	38	12	58	
	Others	0	8	8	25	0	41	0.02
Occupation Vs Properly regulated	Private Employee	4	40	52	111	4	211	
	Professional	0	0	4	28	0	32	
	Govt.	0	8	32	24	0	64	
	Business	0	0	37	21	0	58	
	Others	0	4	20	17	0	41	0.00
Occupation Vs Comprehensive	Private Employee	0	16	64	131	0	211	
	Professional	0	0	4	24	4	32	
	Govt.	0	8	16	36	4	64	
	Business	0	0	8	38	12	58	
	Others	0	8	8	25	0	41	0.00
Occupation Vs Change effect	Private Employee	0	0	40	146	25	211	
	Professional	0	0	0	32	0	32	
	Govt.	0	0	40	16	8	64	
	Business	0	0	16	34	8	58	
	Others	0	0	0	41	0	41	0.00

Source: Primary data computed and compiled using SPSS