

IMPACT OF CREDIT RATINGS ON INDIAN CORPORATE DEBT ISSUANCE

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Abstract: Corporate debentures serves a source of long term fund and also provides Investment Avenue for general public. The role of corporate debt market is increasing as it promotes efficiency of capital which leads to growth of the economy. A well-developed corporate bond market is critical for Indian economy as it enables efficient allocation of funds. The study of bond rating is essential because investors rely on bond ratings when they invest in bonds. This study primarily focuses on the impact of credit ratings of the subscription of publicly placed corporate bonds issued from 2014 to 2017. Analysis is done using SPSS. It was found that credit rating influences the subscription of bonds and public sector firms get better rankings when compared to private sector. It is also understood from the study that the number of public placements is decreasing and government should take appropriate steps to boost demand for corporate bonds.

Index Terms- Corporate bonds, Credit ratings, subscription.

I. INTRODUCTION

The Capital Market of an economy is developed with the growth of both equity and debt markets. The Indian equity market is undoubtedly well structured and developed but Indian debt market requires expansion and tremendous growth in respect to other developed economies. Internationally debt markets are much more popular than the equity markets. But in India the reverse is dominating as the size and growth of the debt market depends upon varied factors, including financing patterns and capital structure of companies. The government debt market has been in dominance over corporate debt market in the last decade. The corporate bond market which contributes a large in minimizing the weighted average cost of debt capital form very insignificant part in their issuances in the total capital structure of various firms.

Numerous recommendations are given by expert committees, many measures are made by the Government of India, the Reserve Bank of India (RBI) and the Securities and Exchange Board of India (SEBI) for the growth of corporate debt market in India. Credit rating serves as an important input for the decision making of varied participants. The behavior of subscription of debentures, it's trading and the key determinants are attracting various thinkers to extensively research in different parts of the world. Certain studies are conducted by different bodies to explore new insights for the growth of corporate debentures.

Credit rating is practicality done for several financial instruments such as bonds, fixed deposits, mutual funds schemes and even equity shares. As it is mandatory by SEBI guidelines to rate a bond therefore ratings as a basis of information for investors has improved in recent years leading to the development of corporate bond market. In view of the increasing support on bond ratings in credit risk markets, it is significant to ask how reliable ratings are. Bond ratings are of huge importance to companies as it helps them to establish their creditability & hence raise Long term Funds from the market at reasonable cost of borrowing. Investors too rely on these ratings to assess the default risk level of companies & use the information to form profitable trading strategies. Therefore the analysis starts with the frequency distribution of corporate bonds issued through prospectus with respect to different years under the study. Further ratings of corporate bonds given by credit rating agencies (CRAs) in different years was examined which affects their levels of subscription

II. OBJECTIVES OF THE STUDY

- To analyze the primary issuance of publicly placed corporate bonds
- To examine relationship between bond ratings and subscription of corporate bonds

III. LITERATURE REVIEW

Bhama Venkataramani (2014) researched on possibility of evasion measured by the credit risk on issue of instrument. The paper attempted to assess the quality of credit rating agencies from 2005 and 2013. Researcher used primary and secondary data study for default rates for Indian and International critical performers of credit rating agencies. For examination variables like financial data (net profit, sales, total assets, cash flows etc.) and financial ratios like interest coverage, profit ratio and debt equity ratio were calculated. The paper suggested few reforms and implications to develop the performance of rating by correctness of time, regular checking and by publication of accurate ratio.

Wang and Wu (2014) inspected non-liquidity by calculating the associations among trade volumes, instability and trading occurrence. The data from 2004 to 2012 were considered. The paper identified direct association among volume and volatility. Data was taken on credit ratings, age, issue quantity, coupon rate. Entire publicly traded company's bonds data were taken. It was noted that coupon rates are high with quantity, trade volume where issue volume are less with risky bonds. Paper found that there is a direct association among trading occurrence and volatility and inverse association among trade volume and volatility.

Khan R. Harun (2015) inspected numerous SEBI regulations and actions by RBI, GOI and SEBI for growth of corporate debt markets in India. The research concentrated on necessity for emerging corporate debt market in relation to expert committee's ideas for development and progress of this section. It was experimented that if all market contributors are obligatory to develop unused potential of the country, corporate debt markets will certainly progress in developed economies.

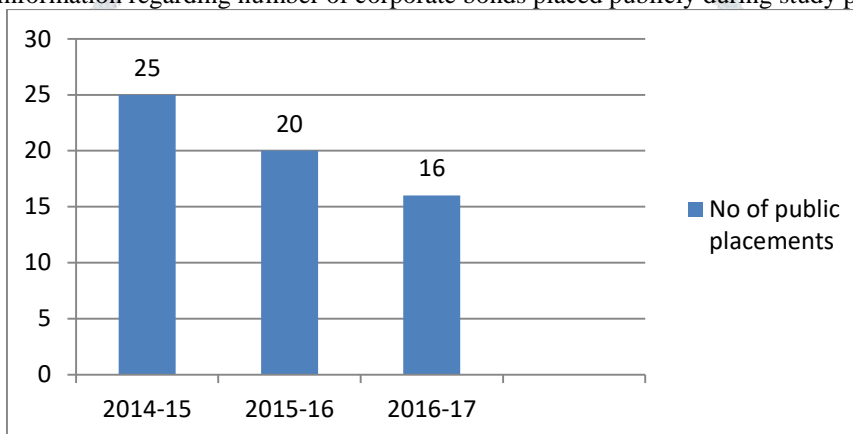
Acharya (2011) examined the present state of corporate debt markets in the country. Analytical and empirical models were done. Cross country study was made, the author recommended that scope of outstanding corporate securities to GDP is extreme in USA, South Korea and Italy and less in India. The research emphasized that financial institutions, manufacturing companies and infrastructure companies control the debt issue in India. Numerous regulations of SEBI were brought with the evolution and references given by R. H. Patel committee.

IV. RESEARCH METHODOLOGY

A research design is a definite plan for obtaining a sample from a given population. This research study is conducted following a descriptive research design and empirical research design as it predicts cause and effect relationship. The corporate bonds that are delivered through public issue are considered in the study. The corporate bonds that are issued by private placement are not included in the study. The rating of ICRA is taken for credit rating. Period of study is 3 years, from 2014 - 2017. The data has been analysed for long term debt instruments. Short term debt instruments are excluded. The universe of the study is 61 long term debt issues and all the issues are taken as the sample. To maintain consistency in records, the companies where information was not available for the entire time span were filtered out.

V. FINDINGS AND DISCUSSION

The following table gives information regarding number of corporate bonds placed publicly during study period



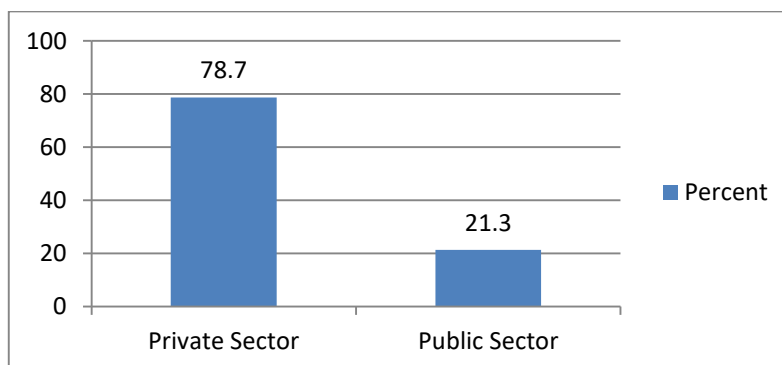
It is noted that the number of public placement has been decreasing from years, it is being diminishing every year from 2014-17. This infers that public placements need more concentration from the SEBI and it has to treat public sector corporate bonds, as the area to be improved

In the following table, the subscription level was divided in to three levels as high, medium and low and its frequency distribution is as follows

		Frequency	Percent
Subscription	Over subscription	57	93.4
	Same subscription	3	4.9
	Under subscription	1	1.6
	Total	61	100.0

The above graph shows that the over subscription is too high compared to same and under subscription.93.4% of the total subscription is been oversubscribed and 4.9% of same subscription which is comparatively higher than under subscription with 1.6%

The subscription was analyzed with respect whether the company issued the bond is private sector or public sector and the results are as follows



The above graph shows that the bond issue is being dominated by private sector with 78.7%. Public sector bonds own only 21.3%. Public sector bonds to be given more attention as Indian bond markets still need improvement in global markets.

The following table gives information regarding frequency and percent of credit ratings of corporate bonds placed publicly during study period

		Frequency	Percent
CREDIT RATING	A	6	9.8
	A-	3	4.9
	A+	1	1.6
	A1+	3	4.9
	AA	6	9.8
	AA-	3	4.9
	AA+	3	4.9
	AAA	15	24.6
	BB+	15	24.6
	BBB	3	4.9
	BBB+	2	3.3
	D	1	1.6
Total		61	100.0

From the above table, it is noted that frequency of AAA and BB+ ratings are equal and comparatively high than other ratings over a period of 3 years. The next highest is A and AA ratings. The least is A+ and D with 1.6 percent.

In order to analyze whether the corporate bond credit rating influences subscription level, chi-square analysis was done and the results are as follows

		Subscription level			Total
		Over subscription	Same subscription	Under subscription	
Credit Rating	A	6	0	0	6
	A-	3	0	0	3
	A+	0	0	1	1
	A1+	3	0	0	3
	AA	6	0	0	6
	AA-	3	0	0	3
	AA+	3	0	0	3
	AAA	14	1	0	15
	BB+	15	0	0	15
	BBB	1	2	0	3
	BBB+	2	0	0	2
D	1	0	0	1	
Total		57	3	1	61

	Value	Df	P-value
Pearson Chi Square	87.754	22	0.000

Since $p < 0.05$, null hypothesis is rejected at 5% level of significance. There is an association between credit rating and Subscription of bonds

To test whether the credit rating changes with the sector (private / public), Kruskal Wallis test was done and it is seen that

		Sector		Total
		Private Sector	Public Sector	
Credit rating	A	6	0	6
	A-	3	0	3
	A+	1	0	1
	A1+	3	0	3
	AA	6	0	6
	AA-	3	0	3
	AA+	3	0	3
	AAA	4	11	15
BB+	15	0	15	

	BBB	3	0	3
	BBB+	0	2	2
	D	1	0	1
Total		48	13	61

	Value	Df	P-value
Pearson Chi Square	43.508	11	0.000

Since $p < 0.05$, null hypothesis is rejected at 5% level of significance. There is association between credit rating of bonds of companies and sector (public / private). It was also seen that public sector companies are given good ratings when compared to private sector. The issue size of a bond offering is the number of bonds issued multiplied by the face value and to understand whether the issue size. To identify whether the base issue size influences the credit risk (credit rating) associated with bond, chi square was done.

	Value	Df	P-value
Pearson Chi Square	33.080x	26	0.160

Since $p > 0.05$, null hypothesis is accepted at 5% level of significance which implies that issue size do not influence the credit rating.

VI. SUGGESTIONS

There is huge potential for growth of corporate bond market in India. Mostly debt issues are through private placement where public issues are not popular in India. As far as municipal bonds are concerned they are almost non existing market which should be Enhanced among investors. The number of regulatory measures to create efficient market for investors and issuers are required as well as structural changes should concentrate for integration of international markets. For encouraging the demand of corporate debt market, norms of investments for regulatory bodies should be reviewed. The government should also encourage young and newly established companies to enter the primary market to develop the corporate bond market. SEBI and other regulatory bodies should encourage the investor's participation in corporate debts by improving the method of determining the fair issue price and successful participation of all companies" information leading to more transparency.

VII. CONCLUSION

Though issuing bonds could be preferred route for issuers for financing their funds. Current market structure lacks liquidity and transparency both in primary issuances and secondary market which influences the investors" confidence in corporate bond market. Therefore policy reinforcement could bring a step change which will enable to transform the share of corporate bonds in India. Further the rating agencies should focus their rating opinions as consideration for investors to rely on their decision which can gain confidence for these agencies.

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