

PERFORMANCE ANALYSIS OF CRISIL CREDIT RATING AGENCY

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Abstract: *The Indian economy in general and Indian financial system in particular has entered a new era in the 1980s (Siddiah, 2011). This new era gave rise to several opportunities and risks associated with instruments of issuers, which in turn created highly competitive and demanding environment. Owing to the growth of financial markets and investments, various innovative instruments were created. The complexities associated with these innovative instruments and the reputation of the newly emerging companies necessitated the emergence of Credit Rating Agencies (CRAs) to restore the confidence among the investors, by rating the borrowers/issuers. The data gathered from various sources show that CRISIL considers business risk, financial risk, management risk and project risk predominantly to assess the credibility of issuer/instrument, It is also observed that Crisil had lesser default rates and highest stability was found in BBB Rating Grade.*

Key Words: *Innovative Instruments, Credit Rating, Determinants, Rating Stability, Rating Accuracy.*

1. Introduction

The changing economic environment has a great impact on every business activity. Economic development has been playing a decisive role in accelerating the growth of the economy and financial markets. The Indian economy in general and Indian financial system in particular has entered a new era in the 1980s (Siddiah, 2011). This new era gave rise to several opportunities and risks associated with instruments of issuers, which led to highly competitive and demanding environment. In this competitive and demanding environment, the issuers became jittery about their profitability as the assurances of the closed economy ceased to exist. The developing economies in general and India in particular found it extremely difficult to mobilise funds to meet the increasing needs of the industry. The number of companies relying on the capital market has also substantially increased. Owing to the growth of financial markets and investments, various innovative instruments were created. The complexities associated with these innovative instruments and the reputation of the newly emerging companies necessitated the emergence of Credit Rating Agencies (CRAs) to restore the confidence among the investors, by rating the borrowers/issuers. It is in this milieu, various CRAs got established in India. CRISIL is the brain child of CRAs in India, which got established in 1988. The fall of big giants such as Satyam, Kingfisher has raised concerns towards the functioning of CRAs. In this backdrop, performance analysis of CRISIL is conducted to get the first hand reliable information about the functioning and performance of CRISIL CRA.

2. Problem Statement

In the backdrop of the recent wave of corporate scandals and the fall of big czars such as Satyam, Lehman Brothers, Kingfisher and such others, CRAs are criticised extensively for their lacking of credibility, reliability, accuracy, transparency and timeliness. Hence, Joseph Stiglitz (1974), winner of Nobel prize in Economics commented that CRAs are the entities which need credibility, before they venture to test the credibility of others. In addition to this, the debate on the CRAs existence, the rating process, the determinants used by CRAs and information content in their ratings has spurred across the world since the collapse of the giant entities. In this background an attempt is made to study the performance of Crisil CRA.

3. Objectives

- To understand the rating process and the determinants of CRISIL
- To assess the financial performance of CRISIL
- To examine the accuracy of CRISIL credit rating
- To study the stability and transition of CRISIL ratings

4. Research Methodology

- **Scope and period of study:** Crisil Credit Rating Agency being the largest and oldest is considered for the study. Data from 2003 to 2016 is considered for analysis.
- **Data Sources:** Annual Reports of CRISIL, Crisil Website, Default Reports.

5. Data Analysis and Interpretation

5.1 CRISIL Rating Process

The process of rating an instrument or an issuer at CRISIL starts with a rating request from the management of the issuing company. The rating agreement is signed by the client (the management of the issuer company) and the rating agency's business development team (comprising of senior business development officer, business development officer and team leader) after the interaction and finalisation of the rating fees. After the rating agreement is signed, the CRISIL analytical team (called rating team comprising of chief analytical officer, chief economist, senior director, director, associate director, team leader, manager and economic analyst) is given the

task of assessing the issuer’s creditworthiness. This rating team collates preliminary information through site visits and interaction with management of client relating to the business profile, the management profile and the financial risk profiles.

After the preliminary analysis is made, an in depth interaction with the client (management) is undertaken by the rating team to cover wider aspects pertaining to the competitive position and the strategy of the organisation, the financial policy, the past performance, the short and long-term finances and the business prospects. Here, the rating team concentrates mainly on the issuer’s business risk profile and the financial data. After the detailed discussion, the rating team prepares a rating report containing the details of the assessment of the business risk, the financial risk, and the management risks of the issuer. The report prepared is presented to the rating committee (comprising of executive and non executive directors and members with professional experience and expertise who can assess the creditworthiness of the entity/instrument). This rating committee assigns a rating after meticulous discussion on the report prepared by the rating team in the rating committee meeting (RCM).

At the RCM, the rating is finalised and the rating is conveyed to the issuer. A document (rating rationale) containing the primary reasons for assigning the rating is shared with the issuer. This is done to assist the issuer to understand the key factors that are considered in the rating decision. If the issuer is convinced with the rating assigned, the issuer will send a letter of acceptance to CRISIL. If, on the other hand, the issuer disagrees with the rating decision, it (issuer) can appeal for a fresh look at the rating assigned. The issuer has to submit additional facts/data/information to the ratings team, which in turn is presented to the rating committee. The rating committee upon receiving the additional information makes a thorough inquiry and may or may not decide to change the rating, depending on the facts of the case. In case, the rating committee decides not to change the rating, then the issuer has an option of not accepting the rating. But, SEBI has made it mandatory for CRAs to publish such unaccepted credit ratings on their website. Hence, all the unaccepted ratings are being disclosed on CRISIL’s website. A detailed flow chart of CRISIL's rating process is given in Figure 1.

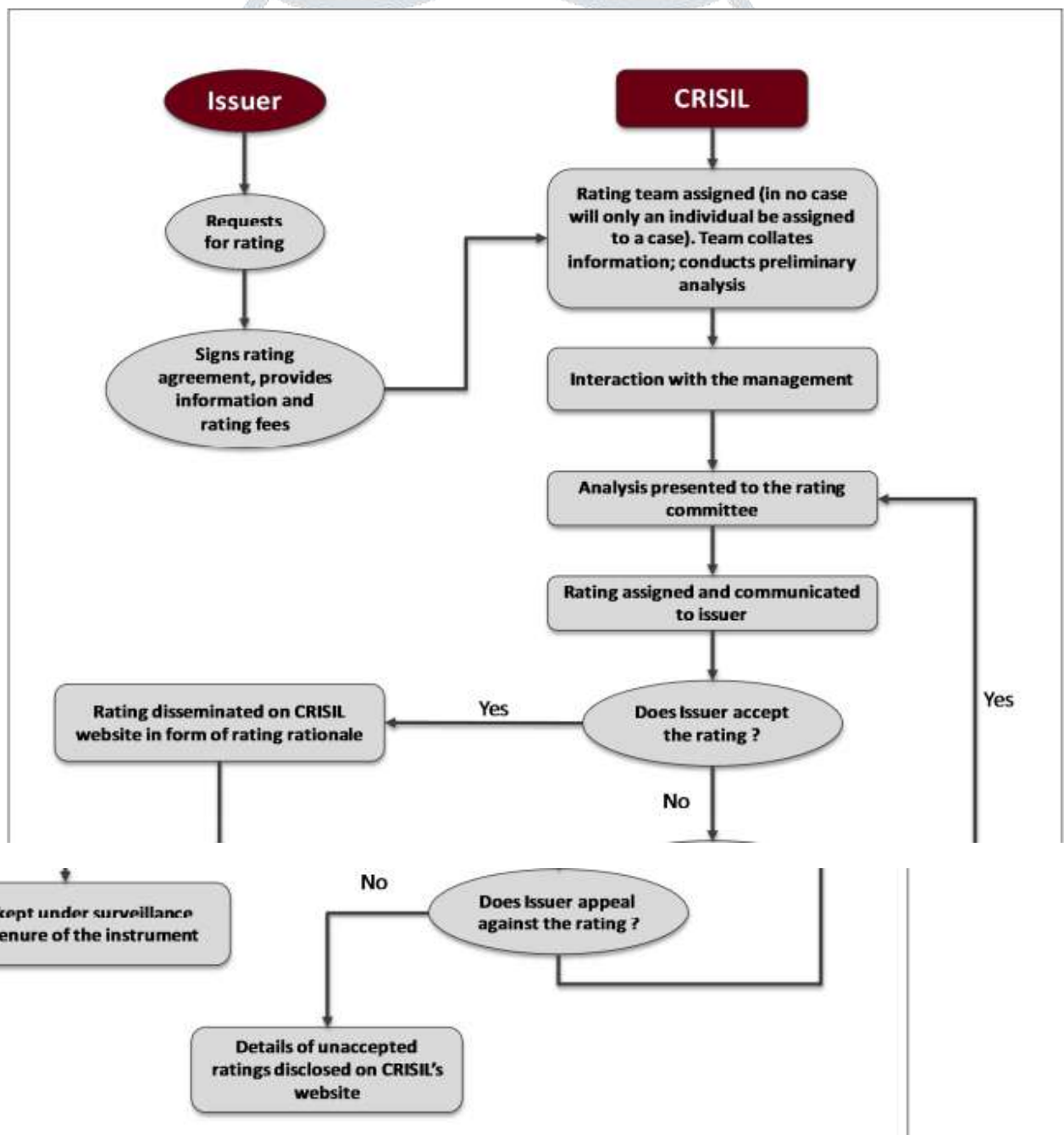


Figure 1: CRISIL Rating Process

Source: CRISIL Rating Process

5.2 CRISIL RATING DETERMINANTS

1. **Business Risk Analysis** - Business risk analysis covers the assessment of the environment in which the industry operates. In other words, it deals with the industry risk, the market position and the operating efficiency.
 - **Industry Risk** - CRISIL evaluates the industry risk in terms of the size of the industry, the growth prospects, the competitive position, the demand and supply, the vulnerability of the industry to technological change, the government policies pertaining to the industry, the entry barriers, the profitability and the cyclical nature of the industry.
 - **Market Position** - CRISIL evaluates the market position from two important dimensions. The first one is in terms of the degree of competition in each market segment and the second one is by analyzing the entry barriers of the industry and capacity of the existing players to expand their business.
 - **Operating Efficiency** - The factors considered in analysing operating efficiency vary from industry to industry. Some of the key factors are technology employed, access to resources in general and human resources in particular, economies of scope and scale, flexibility in the processes, extent of integration and research and development.
2. **Financial Risk Analysis** - CRISIL analysis financial risk of an entity by emphasising on sustainability and adequacy of the issuers' cash flows in relation to its debt servicing obligations. The key factors used by CRISIL for evaluating financial risk are the accounting quality, the adequacy of cash flows and the financial flexibility. CRISIL also considers various financial ratios such as Gross Profit Margin (GPM), Earnings Before Interest and Tax (EBIT), Operating Profit Margin (OPM), Return on Capital Employed (ROCE) and Return on Assets (ROA) mainly while analyzing the financial risk profile of a firm.
 - **Accounting Quality** - The financial ratios/facts and statements used by CRISIL to evaluate the company's performance are derived from audited financial statements. Some of the key areas analysed are the profits, the comments of the auditors, the method of income recognition and depreciation employed by the company, Inventory valuation policies of the company and the Off-balance-sheet items/contingent liabilities.
 - **Adequacy of cash flows** - CRISIL assesses the future earning capacity in relation to its debt servicing obligations. CRISIL's analysis is cash flow based and it assesses the firms' financial performance (income statement) and firms' financial position (balance sheet).
 - **Financial flexibility** - Some of the indicators of the financial flexibility considered by CRISIL are as follows:-
 - The firms' ability to generate the funds through alternate sources (in the event of financial distress); internal sources (internal accruals) and external sources (relationship with bankers and access to capital markets) are evaluated to cover temporary shortfalls.
 - The firms' contingency plans and its ability to deal with various adverse scenarios are analysed.
 - The company's record in raising funds from the capital markets, liaison with the bankers and the other institutions, and the amount of marketable securities are also analysed.
3. **Management Risk Analysis** - It entails understanding the goals and the strategies that drive the company businesses performance in general and financial performance in particular. Evaluation of the management risk involves:-
 - Understanding the organisational reporting structure
 - Management's experience, level of commitment, track record in debt payments in general and introducing new products and its ability to manage change in the external environment, such as regulatory or technological change in particular are analysed.
 - Adequacy of firms planning in terms of succession, control systems, and corporate governance principles are measured. The firms overall risk appetite is also assessed.

5.3 Financial Performance of CRISIL

The growth of any organisation to a very great extent depends upon the sound finances. The table 1 gives a snap shot of CRISIL performance from 2003 to 2016.

Table 1: Financial Performance of CRISIL

Financial Performance Indicators (Rs in Cr)	Income from Operations (Cr)	EBITDA (Cr)	PAT (Cr)	Market Capitalisation (Cr)	Dividend (%)	EPS (Rs)	Revenue Per Employee (Rs in Lakhs)
2003	71	30	17	158	100	2.7	19.96
2004	85	30	19	312	100	3.1	20.15
2005	119	39	45	438	125	3.5	21.53
2006	287	81	61	1008	100	8.8	22.93
2007	404	117	84	1521	250	11.8	25
2008	515	179	141	2664	700	19.5	27.8
2009	537	199	161	1773	1000	22.3	26.1
2010	628	215	165	4262	1000	28.5	25.3
2011	807	262	202	6206	1100	29.1	26.9

2012	978	328	219	7607	1300	31.1	29.4
2013	1111	361	254	8484	1300	36.1	32.4
2014	1253	388	268	13551	1600	37.8	36.3
2015	1380	400	285	14009	2000	40	38
2016	1547	462	326	15694	2700	45.8	40.1

Source: Various Annual Reports of CRISIL

It is observed from the table that there is a continuous increase in the income generated by CRISIL every year. It multiplied from rupees 71 Crore in 2003 to rupees 1547 Crore in 2016 reporting an increase of 21.79 times in a span of fourteen years. Similarly, the earnings of the company also registered a positive trend year on year. The market capitalisation of the company has also grown in leaps and bounds from 158 Crore in 2003 to 15694 Crore in 2016. The shareholders have also benefited from improved revenues and profits, as EPS improved every year. However, it can also be deduced that the financial performance of CRISIL is directly proportional to the number of assignments it undertakes which in turn greatly depends on the market activity (number of instruments floated).

5.4 Rating outstanding and Defaults of CRISIL

Table 2: No of Ratings Outstanding and Defaults of CRISIL

Year	Outstanding Ratings for the year	Defaults	Accuracy (%)
2001	243	11	95.47
2002	514	3	99.42
2003	803	1	99.88
2004	1082	3	99.72
2005	1383	0	100.00
2006	1664	0	100.00
2007	1969	0	100.00
2008	2506	6	99.76
2009	3494	43	98.77
2010	4206	68	98.38
2011	5029	161	96.80
2012	6376	341	94.65
2013	7615	346	95.46
2014	9187	378	95.89
2015	11280	395	96.50
2016	13572	403	97.03

Source: CRISIL Website and Annual Reports

Accuracy of ratings can be measured in terms of the number of defaults. It is observed from the table 2 that CRISIL had 243 ratings outstanding for the year 2001 and eleven of ratings failed/defaulted in that year, which shows that the rating accuracy of CRISIL for the year 2001 was 95.47 per cent. The number of rating outstanding increased every year. The rating accuracy of CRISIL was 100 per cent for three consecutive years from 2005 to 2007. As of 2016, 13572 ratings are outstanding. Of which, 403 ratings defaulted, which projects rating accuracy of 97.03 per cent. CRISIL rating accuracy ranges from 94.65 per cent to 100 per cent.

5.5 CRISIL Rating Stability and Transition Rates

The quality and accuracy of rating can be evaluated by analysing the stability (sustainability) of ratings assigned and the transition rates. Stability of rating refers to the sustainability of the rating assigned and transition refers to the movement of rating from one grade to the other (upgraded or downgraded from its original position). Table 3 shows the CRISIL rating grade transition for a period ranging from 2006 to 2016. It is evident from the table that, AAA rating grade exhibited highest stability of 97.37 per cent. 2.63 per cent of the ratings were downgraded to AA. It is also seen that the stability in AA rating grade is 93.32 per cent. It is observed that AA rating was downgraded to all the lower grades (transition is high) that is 4.49, 0.49, 0.16, 0.03, 0.02 and 0.04 per cent of the ratings were downgraded to A, BBB, BB, B, C and D respectively. While only a small portion of 1.45 was upgraded to AAA rating grade. The A rating category saw a stability of 88.91 per cent, while 3.04 per cent of the A ratings were upgraded to AA and 5.72 percent, 1.48 per cent, 0.11 per cent, 0.23 per cent and 0.51 percent were downgraded to BBB, BB, B, C and D rating grades respectively. BBB, BB, B rating grade displayed a stability of 89 per cent, 87.66 per cent and 84.15 per cent respectively. Similarly, the lowest of 59.46 per cent continued to remain in C rating grade with 20.92 per cent being downgraded to D category and 17.99 per cent was upgraded to B category. This shows that CRISIL ratings were not stable during this period.

The above data shows that the rating grades were moved from investment grade to non investment grade and to default. This alarming transition rates highlight that the CRAs rating methodology is lax, lenient and is issuer friendly. This may be owing to the issuer paying model.

Table 3: Rating Stability and Transition of CRISIL during 2003-16

Rating Category	CRISIL AAA	CRISIL AA	CRISIL A	CRISIL BBB	CRISIL BB	CRISIL B	CRISIL C	CRISIL D
CRISIL AAA (%)	97.37	2.63	0.00	0.00	0.00	0.00	0.00	0.00
CRISIL AA (%)	1.45	93.32	4.49	0.49	0.16	0.03	0.02	0.04
CRISIL A (%)	0.00	3.04	88.91	5.72	1.48	0.11	0.23	0.51
CRISIL BBB (%)	0.00	0.04	2.64	89.16	6.53	0.39	0.23	1.01
CRISIL BB (%)	0.00	0.01	0.01	3.89	87.66	4.04	0.44	3.95
CRISIL B (%)	0.00	0.00	0.01	0.05	7.25	84.15	0.53	8.02
CRISIL C (%)	0.00	0.00	0.00	0.15	1.49	17.99	59.46	20.92

Source: CRISIL Default study

6. Conclusion

The CRAs in India is the brain child of CRISIL. Crisil largest shareholder is S&P. The financial performance of Crisil show that the earnings have increased every year owing to the range of ancillary services providing by them. The ratings stability and transition rate during the period of 2003 to 2016 show that the 'AAA' rating grade has the highest stability and has moved down by only one notch that is to 'AA' rating grade. The 'C' rating category showed the lowest stability and eventually was downgraded to Default grade. The CRAs may have provided higher initial ratings to appease the issuer and subsequently downgraded the instrument or issuer when deterioration was apparent. The accuracy of ratings is measured by the number of defaults and the rating sustainability of CRAs. It is observed that CRISIL had lesser default rates and highest stability is found for BBB rating grade.

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