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Careful Evaluation of CARE's Performance

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ABSTRACT

A retail investor may not be competent enough to process and interpret the investment related information. It is highly difficult to identify the risk of default in respect of instruments. There are a number of rating agencies playing an important role in providing quality inputs to support investment decision. Though they have become important part of investment system, their working has been criticized. In the light of this, an attempt has been made in this paper to evaluate the services of CARE Ratings. The paper appreciates the rating services of CARE and suggests to strengthen the methodology to serve the investors and the market.

Keywords : Capital Market, Credit Rating, Risk Assessment, Equity Research

Introduction

A potential investor must evaluate various aspects such as issuer of security, industry, instruments, current performance, future prospects, etc to take a rational investment decision. Before investing in securities, he must assess the risk of default. The investors may not be competent enough to process and interpret the information. They may not be able to understand the finer aspects of information. It is highly difficult to identify the risk of default in respect of bonds, debentures, commercial papers, structured obligations, etc. There lies the significance of specialized market intermediaries who can assist the investors to make them understand the fundamentals of the company and market, and read between the lines of information.

Spectrum of Services

CARE offers a wide range of ratings and grading services across sectors. The services offered by CARE can broadly be classified into three categories. They are, (1) Rating Services, (2) Research and Information Services, and (3) Equity Research.

01. Rating Services

The Rating Division of CARE has eighteen years of experience in Rating debt instruments. The services under this category comprise of Rating the instruments issued by industrial companies, service companies, banks, financial institutions, non-banking financial companies, public sector undertakings, government undertakings, municipal corporation, etc. It is rating all types of debt instruments like Commercial Papers, Fixed Deposits, Bonds, Debentures, Hybrid Securities, Preference Shares, Loans, Asset Backed Securities (ABS), Residential Mortgage Backed Securities (RMBS), etc. It also undertakes the rating of structured finance transactions, securitization transactions, small and medium enterprises (SMEs) and micro finance institutions. The following data show a brief account of Ratings.

Table 1: Ratings by CARE up to December 31, 2007

Sl. No	Particulars	Performance
01	Assignment Completed	3,850
02	Number of Instruments Rated	3,537
03	Volume of Debt Rated (Rs. billion)	8,071
04	Number of Issuers Rated	1,190

Source: www.careratings.com

It can be observed from the above that CARE has completed 3,850 assignments and rated 1,190 issuers. It has rated 3,537 instruments worth Rs. 8,071 billion. The average amount of debt involved per instrument of debt rated by CARE works out to Rs. 2.28 billion. These statistics substantiate the importance of CARE in Indian economy.

02. Research and Information Services

This division provides information on companies, industries, sectors or the whole economy. This would help the investors, both individual and institutional, to take informed decisions on their investment. It provides real time information on financial markets. It publishes various research publications like Industry Research Reports with updates, Debt Market Review, Budget Analysis, special commentaries on topical issues and other policy impact analysis. It also offers customized reports on request.

03. Equity Research

CARE takes the responsibility of one of the toughest tasks of offering the services on equity. This task is not so easy as in the case of debt instruments. Still, CARE is taking this responsibility as it has strong research base to offer these services. It conducts research on the companies listed and to be listed on the recognized stock exchanges. The research involves fundamental analysis which in turn takes into consideration the track record of management, profitability, competitiveness, market position, prospects of industry, in general, and the company in particular, etc. This research initiative helps (particularly) small investors who do not have access to sensitive and material information.

Performance Evaluation of CARE Ltd

CARE has completed 3,850 assignments by December 31, 2007. It has rated 3,537 instruments, and the amount of debt instruments rated comes to Rs.8,071 billion as on December 31, 2007. Number of issuer-companies covered under rating as on that date was 1,190. CARE charges a fee for rating of debenture, fixed deposit and commercial paper at 0.10 per cent of the issue amount subject to a minimum of Rs.2,00,000 and it charges a surveillance fee at 0.05 per cent on all outstanding debts as on last balance sheet date subject to a minimum of Rs. 3,00,000.

01. Number of Revisions

The details about the number of financial instruments whose grades were revised are presented below.

Table 2: CARE's Rating Actions

Year	Rating Action		Ratio of Downgrades to Upgrades
	Upgrades	Downgrades	
1998-99	02	44	22.00
1999-00	04	28	07.00
2000-01	06	08	1.33
2001-02	03	20	6.67
2002-03	02	25	12.50
2003-04	06	03	0.50

Source: Various issues of CARE View

It can be seen from the above table that during the years 2000-01 and 2003-04, six instruments each were upgraded. This was the highest number of instruments upgraded. The upgrades were very low during the years 1998-99 and 2002-03. Upgrades did not pose any problem. It was also observed that these upgrades were almost by a single notch in the same category.

In the case of downgrades, during the years 1998-99 and 1999-2000, 44 and 28 instruments were pushed down respectively. Ratio of downgrades to upgrades was alarming at 22 in 1998-99 followed by 12.5 RDU for 2002-03. 2003-04 was considered as the best year where a minimum number of downgrades were seen. RDU was also at 0.5.

02. Rating Stability and Travel

One of the important determinants of quality of rating is the stability of the ratings assigned. The table presented below shows the rating stability and travel during the period of one year. It may be noted here that the Stability of Rating refers to the sustainability of initial rating assigned to the instrument, and Rating Travel refers to movement (downgrade or upgrade) of rated instruments from one grade to another grade. For the purpose of this study, the rating is considered as stable even if there is an upgrade or a downgrade by one or two notch within the same category. For instance, an instrument rated 'A', upgraded to A+ (A plus) or downgraded to A- (A Minus) is considered as stable in the category 'A'. The Rating travel and stability is ascertained for one year based on the outstanding Ratings at the beginning of the year. The study focuses investment grade Ratings and all other Ratings are grouped into Non-Investment (NI) grade.The details about the stability and travel aspects of the instruments rated by CARE are presented below:

Table 3: CARE's Rating Stability and Travel (%age)

Grade	Year	AAA	AA	A	BBB	NI
AAA	1998 - 99	**96.00**	4.00	-	-	-
	1999 - 00	**100.00**	-	-	-	-
	2000 - 01	**100.00**	-	-	-	-
	2001 - 02	**97.14**	2.86	-	-	-
	2002 - 03	**88.90**	5.55	-	-	5.55
	2003 - 04	**100.00**	-	-	-	-
AA	1998 - 99	-	**74.47**	19.15	-	6.38
	1999 - 00	-	**64.86**	35.14	-	-
	2000 - 01	4.76	**95.24**	-	-	-
	2001 - 02	-	**88.00**	12.00	-	-
	2002 - 03	-	**94.40**	5.60	-	-
	2003 - 04	4.17	**91.66**	-	-	4.17
A	1998 - 99	-	3.57	**64.29**	14.29	17.85
	1999 - 00	-	-	**76.19**	9.52	14.29
	2000 - 01	-	-	**90.90**	6.10	3.00
	2001 - 02	-	5.00	**85.00**	2.50	7.50
	2002 - 03	-	2.33	**72.09**	11.63	13.95
	2003 - 04	-	3.13	**93.75**	-	3.12
BBB	1998 - 99	-	-	-	**37.50**	62.50
	1999 - 00	-	-	-	**83.33**	16.67
	2000 - 01	-	-	-	**70.00**	30.00
	2001 - 02	-	-	-	**71.43**	28.57
	2002 - 03	-	-	-	**75.00**	25.00
	2003 - 04	-	-	33.33	**55.60**	11.10

Source: Various issues of CARE View

The above table gives an idea about CARE's Rating travel from its initial destination and the Rating stability in the initial place. It can be observed from the table that the instruments with AAA Rating, during the years 1999-2000, 2000-01 and 2003-04, stood firmly exhibiting 100 per cent stability. During 1998-99 and 2001-02, the rated instruments were relatively stable. Only 4 per cent of "AAA" rated instruments departed to very next lower level Rating category during 1998-99. 2001-02 was still better than the year mentioned previously as only 2.86 per cent of instruments took a tour to lower destination. However, CARE's AAA rated instruments affected the investors as 5.55 per cent of the instruments moved to AA and devastatingly another 5.55 per cent of the instruments landed in danger zone (non-investment grade) during 2002-03. The stability during that year was very low when compared to other years.

In the case of AA rated instruments, there was no 100 per cent stability in any of the years. Out of the rated instruments, 6.38 per cent in 1998-99 and 4.17 per cent in 2003-04 made a move to non-investment grade area. Three instruments rated as AA in 1998-99 reached the lower end of Rating i.e., D. During the year 1999-2000, stability was very low at 64.86 per cent and the remaining 35.14 per cent of AA rated instruments moved to A category. 2000-01 had seen a stability of 95.24 per cent and 4.76 per cent of the instruments moved up to AAA, the highest Rating category.

Conclusion

No system is foolproof but one should always try hard to improve its working standards to create value addition to the market and economy. Retail investors who do not have required expertise to assess the associated risk with the financial investments depend very much on this kind of expert organizations for taking investment decisions. Credible and quality services serve the interest of those investors. The rating agencies can also supplement the resources of the institutional investors by their quality inputs with regard to assessment of highly risky investment. The careful evaluation of the working of CARE reveals that it is offering various useful services to the investors in and issuers of the securities. It also helps in strengthening the capital market and economy. The CARE should apply rigorous tools and methods in assessing the quality of the instruments in the interest of the investors and the efficiency of the market.

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