A Descriptive Study of Credit Rating of Indian Railway Finance Corporation Ltd.

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Abstract

A credit rating is an opinion of a particular credit agency regarding the ability and willingness an entity (government, business, or individual) to fulfill its financial obligations in completeness and within the established due dates. A credit rating also signifies the likelihood a debtor will default. It is also representative of the credit risk carried by a debt instrument – whether a loan or a bond issuance.
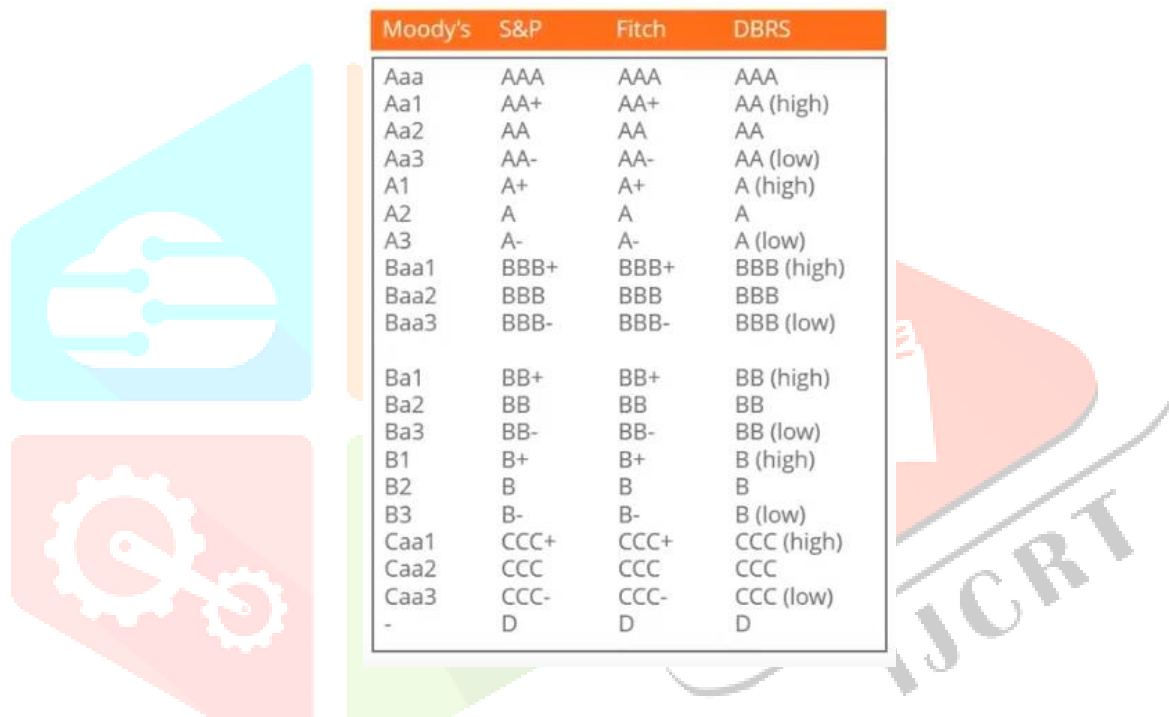
This paper makes an attempt to understand the concept of concept of credit rating and also how has a mini-ratna company like Indian Railway Finance Corporation (IRFC from here on) fared in the credit rating score over the last few years, which will be in qualitative framework by reviewing few already existing researches in credit rating. It will also involve case analysis to critically examine various debates on credit rating.

Key words: Credit rating, credit agency, debtor, credit risk, credit agencies.

Introduction

A credit rating is an opinion of a particular credit agency regarding the ability and willingness an entity (government, business, or individual) to fulfill its financial obligations in completeness and within the established due dates. A credit rating also signifies the likelihood a debtor will default. It is also representative of the credit risk carried by a debt instrument – whether a loan or a bond issuance.

Table 1: Credit rating scores in different credit rating agencies

Moody's	S&P	Fitch	DBRS
Aaa	AAA	AAA	AAA
Aa1	AA+	AA+	AA (high)
Aa2	AA	AA	AA
Aa3	AA-	AA-	AA (low)
A1	A+	A+	A (high)
A2	A	A	A
A3	A-	A-	A (low)
Baa1	BBB+	BBB+	BBB (high)
Baa2	BBB	BBB	BBB
Baa3	BBB-	BBB-	BBB (low)
Ba1	BB+	BB+	BB (high)
Ba2	BB	BB	BB
Ba3	BB-	BB-	BB (low)
B1	B+	B+	B (high)
B2	B	B	B
B3	B-	B-	B (low)
Caa1	CCC+	CCC+	CCC (high)
Caa2	CCC	CCC	CCC
Caa3	CCC-	CCC-	CCC (low)
-	D	D	D

Source: Credit Rating - Overview, Types, and Users of Credit Ratings (corporatefinanceinstitute.com)

The proposed study makes an attempt to understand the concept of credit rating in particular reference to IRFC. For long, corporate governance has been a barometer regarding the ability and willingness an entity (government, business, or individual) to fulfill its financial obligations in completeness and within the established due dates.. The question arises why not study credit rating with reference to a mini-ratna government undertaking like the Indian Railway Finance Corporation. And more so, in the world where ethics and codes have taken a serious hit, it becomes imperative to delve into the nitty-gritty of credit rating as at the end of day customers (general public) are at the receiving end. Now, this study becomes more appropriate because of the following reasons; firstly, Indian railways touches the life of the largest number of

people when compared to any other rail network in any country of the world, secondly, it is the largest monopoly in India, and thirdly, IRFC was set up in 1986 with the objective of meeting part of Indian Railways' funding needs for infrastructure creation through market borrowing.

Objectives of Study

- To study the concept of credit rating and its relevance in IRFC in the light of the available literature.

- To understand as to why IRFC has been continuously credit rated high; cite reasons for the same.

- To provide suggestions for improving credit scores in general.

Review of literature

Credit Rating in India: A Study of Rating Methodology of Rating Agencies (2011; Kuljeet Kaur, Dr. Rajinder Kaur): This paper tells that the rating agencies use consistent methodology while assigning a particular rating grade as there is no significant difference in the values of all the ratios which belong to different sets of similarly rated companies in maximum cases.

In the paper, **An Analytical Study on Impact of Credit Rating Agencies in India's Development (G Sunitha and Rinku Sanjeev 2018)** it is asserted that the part played by credit rating agencies in the development of a country either directly or indirectly is significant. The paper initially points out that Credit rating helps us to know about the credit capability of individuals in a country. When all the investors are positively rated, then there will be an increase in new startups. Gradually income of the country increases, Employment opportunities expands and Poverty ranks less. When there is development in all the sectors then the GDP increases and country develops.

Role of the credit rating agencies in the financial market crisis (Vandana Gupta; Raj Kumar Mittal; V K Bhalla, August 2010): The objective of this paper is to critically examine the role of credit rating agencies in the sub-prime crisis. The paper traces the development of the sub-prime crisis from its origin till the aftermath. It studies the weaknesses of credit rating agencies in performing their basic function of timely and accurate rating of bond obligations. The paper then scrutinizes the diversification of credit rating agencies

into the structuring and rating of complex securitized products. This raises fundamental issue of the independence and accountability of these agencies. The paper comes to the conclusion that appropriate changes in the regulatory framework of credit rating agencies are necessary to help avert similar crises in the future.

Research Gap

The literature available from various secondary sources was referred to. In general it was found that Public sector and private sector are two different entities with different responsibility. However, in relation to credit ratings, despite of this difference, there are credit rating scores/ principles applicable for both entities. Further, Public entities' credit ratings like in the case of IRFC, a mini-ratna company is a concept that is gaining more and more field both in specialized literature and in practice.

Now, in particular reference to public sector (Indian Railways-IRFC in this case), it was found that a limited amount of research has been conducted in the area of credit ratings even though Indian Railways, not to mention, is a major driver of our economy and therefore certain aspects must be taken very seriously. The proposed study is looking forward to contribute to the field of study of significance of credit rating. When all the investors are positively rated, then there will be an increase in new startups. Gradually income of the country increases, Employment opportunities expands and Poverty ranks less. When there is development in all the sectors then the GDP increases and country develops.

What is a Credit Rating?

A credit rating is an opinion of a particular credit agency regarding the ability and willingness an entity (government, business, or individual) to fulfill its financial obligations in completeness and within the established due dates. A credit rating also signifies the likelihood a debtor will default. It is also representative of the credit risk carried by a debt instrument – whether a loan or a bond issuance.

A credit rating is, however, not an assurance or guarantee of a kind of financial performance by a certain instrument of debt or a specific debtor. The opinions provided by a credit agency do not replace those of a financial advisor or portfolio manager.

Who Evaluates Credit Ratings?

A credit agency evaluates the credit rating of a debtor by analyzing the qualitative and quantitative attributes of the entity in question. The information may be sourced from internal information provided by the entity, such as audited financial statements, annual reports, as well as external information such as analyst reports, published news articles, overall industry analysis, and projections.

A credit agency is not involved in the transaction of the deal and, therefore, is deemed to provide an independent and impartial opinion of the credit risk carried by a particular entity seeking to raise money through loans or bond issuance.

Presently, there are three prominent credit agencies that control 85% of the overall ratings market: Moody's Investor Services, Standard and Poor's (S&P), and Fitch Group. Each agency uses unique, but strikingly similar rating styles to indicate credit ratings.

Types of Credit Ratings

Each credit agency uses its own terminology to determine credit ratings. That said, the notations are strikingly similar among the three credit agencies. Ratings are bracketed into two groups: investment grade and speculative grade.

1. Investment grade ratings mean the investment is considered solid by the rating agency, and the issuer is likely to honor the terms of repayment. Such investments are typically less competitively priced in comparison to speculative grade investments.

2. Speculative grade investments are high risk and, therefore, offer higher interest rates to reflect the quality of the investments.

Users of Credit Ratings

Credit ratings are used by investors, intermediaries such as investment banks, issuers of debt, and businesses and corporations.

- Both institutional and individual investors use credit ratings to assess the risk related to investing in a specific issuance, ideally in the context of their entire portfolio.

- Intermediaries such as investment bankers utilize credit ratings to evaluate credit risk and further derive pricing of debt issues.

- Debt issuers such as corporations, governments, municipalities, etc., use credit ratings as an independent evaluation of their creditworthiness and credit risk associated with their debt issuance. The ratings can, to some extent, provide prospective investors with an idea of the quality of the instrument and what kind of interest rate they should be expecting from it.

- Businesses and corporations that are looking to evaluate the risk involved with a certain counterparty transaction also use credit ratings. They can help entities that are looking to participate in partnerships or ventures with other businesses evaluate the viability of the proposition.

Credit Score

A credit rating is used to determine an entity's creditworthiness, wherein an entity could be an individual, a business, a corporation or a sovereign country. In case of a loan, the rating is used to establish whether a loan should be rendered in the first place. If the process goes further, it helps in deciding the term of the loan such as dates of repayment, interest rate, etc.

In the case of bond issuance, the credit rating indicates the worthiness of the corporation or sovereign country's ability to repay the bond payments in due time. It helps the investor evaluate whether to invest in the bond or not.

A credit score, however, is strictly for indicating an individual's personal credit health. It indicates the individual's ability to undertake a certain load and his or her ability to honor the terms and conditions of the

loan, including the interest rate and dates of repayment. A credit score for individuals is used by banks, credit card companies, and other lending institutions that serve individuals

About IRFC

Vision

To be the pivotal and premier Financial Services Company for the development of Rail Transport Sector while maintaining its symbiotic relationship with the Ministry of Railways.

Mission

To make IRFC one of the leading Financial Service Companies in the country, for raising funds from the capital market at competitive cost for augmenting railway plan finances, duly ensuring that the Corporation makes optimum profits from its operations.

Objectives

In achieving the mission, the objectives of the Corporation are:

- To mobilise resources through market borrowings from domestic as well as Overseas Capital Markets at the most competitive rates & terms as per annual targets given by the Ministry of Railways.

- To explore use of innovative and diverse instruments for raising funds so as to reduce the cost of borrowings to the Company.

- To provide timely funding for acquisition of Rolling Stock assets for use by MOR.

- To leverage the Company's business advantage the large size and diverse activities of MOR is to efficiently provide customised professional services at competitive cost.

- To explore the possibility of financing CPSEs and other entities for creation of rail infrastructure so as to sustain future growth and profitability.

- To make judicious use of derivatives and other emerging products for risk mitigation at appropriate time and optimum cost.

- To strive for high quality service to the investors, lenders and other financial intermediaries and to action prompt redressal of their grievances/problems.

- To ensure optimum utilization of resources.

- To enhance professionalism amongst the employees of the Company through training and other human resource tools.

Conclusion and Recommendations

Conclusions- Why is IRFC credit rated high? ƒ

- IRFC is uniquely placed in the sense that not only is it owned wholly by Government of India, it does business also with Government of India.

- Bulk of IRFC's receivables is from MOR. Receivables from the Sovereign lend to its quality of credit a unique credibility. ƒ

- IRFC's business carries unparalleled role of the Government. Market borrowing targets assigned to IRFC as well as payment of lease rentals by MOR to IRFC both form part of the Railway Budget, which is approved by the Parliament of India each year. ƒ

- Railways are critical to the good health of the national economy. In turn, MOR considers IRFC as of high strategic importance for its critical role in capital formation in Railways. The resultant fillip to investor confidence is valuable indeed.

- Deep understanding of business, pursuit of transparent and ethical business practices, and accumulation and nurturing of professional expertise have gone a long way in establishing IRFC as a most favoured destination for investors and lenders. ƒ

- IRFC's track record in meeting its obligations towards the diverse community of its investors and lenders, with not even a minor default, gives them a unique comfort and confidence. ƒ

- Small size of the organization makes the decision making process smooth and efficient, with the result that IRFC finds itself capable of capturing market cycles at their most optimum levels. ƒ

- The Company retains a balanced mix of innovation and conservatism. Resultantly, without exposing itself to avoidable risks, it has been deriving benefits of diverse markets, investors and financial instruments.

Recommendations- General pointers for improving credit scores

- Reviewing credit report frequently

- Setting up payment reminders

- Paying more than once in a billing cycle

- Diversifying accounts

- Being careful while paying old debts

- Paying attention to credit utilization and many others.

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