

## Unit - 5

### 1. Credit Rating Agency

A credit rating agency evaluates and assesses an individual's or a company's creditworthiness. That is, these agencies consider a debtor's income and credit lines to analyse the debtor's ability to repay the debt or if there is any credit risk associated.

### 2. Expand

ICRA - Investment Information and credit rating Agency of India Ltd.

CARE - Credit Rating Information and credit services of India Limited

CARE - Credit Analysis and Research Limited

### 3. Global Depository Receipt (GDR)

A global depository receipt is general name for a depository receipt where a certificate issued by a depository bank, which purchase shares of foreign company creates a security on a local exchange backed by those shares.

### 4. American Depository Receipt

An American depository Receipt is a certificate issued by a U.S. bank that represent shares in foreign stock. ADRs trade on American stock exchange. ADRs and their dividends are priced in U.S. dollars. ADRs represent an easy liquid way for U.S. investors to own foreign stocks.



## 1. Functions of IFCR CRISIL

- # It has broad application in developing and providing comprehensive ratings.
- # It believes in excellence, teamwork, integrity and accountability to drive an ethical business of ratings.
- # It serves business in eight countries consisting of India, China, Hong Kong, Poland, Argentina, Singapore, USA and UK.
- # Currently, it serves in 86 countries, having a customer base of 100,000.
- # It reduces substantial levels of information asymmetry prevalent in the financial market.
- # Therefore, as a credit rating agency, it provides necessary support to the consulting business, financial services, commercial and investment banks, insurance companies, asset management corporations and private equity players.
- # It offers independent insights and opinions, which in turn becomes a constructive solution.
- # It facilitates business to take up comprehensive and conclusive business and investment decisions.
- # It additionally helps small lenders to take up the right lending calls and allow them to take correct business decisions.
- # In order to arrive at a comprehensive rating, the agency performs extensive due diligence and



# The process of due diligence may comprise the gathering of information from several research-based websites, followed by a meeting with the top management.

## 2. Functions of ICRA

ICRA has a broad-based its services to the corporate and financial sectors, both in India and overseas.

### # Rating Services

ICRA rates rupee-denominated debt instruments such as bonds and debentures; fixed deposit programmes, commercial paper and certificates of deposit and structured obligations and sector-specified debt obligations.

### # Grading Services

ICRA has developed highly specialized evaluation methodologies for grading of construction entities, real estate developers and projects, healthcare entities, maritime training institutes, and initial public offers (IPOs). These grading methodologies have been developed in association with reputable and specialized bodies, associated with the domain.

### # Advisory Services

ICRA offers a wide range of management advisory services. These include, (a) strategic counselling (b) risk management (c) restructuring solutions (d) inputs for policy formulation (e) client specific need based studies in the banking and financial services, manufacturing and services sector etc.,



## \* Outsourcing

ICRA online Ltd, a subsidiary of ICRA, provides technology solutions, targeted at distributors of third party financial products, insurance brokers and stock booking houses. The BPO division of ICRA online ~~services~~ serves financial services companies, financial institutions, investment banks, private equity and venture capital funds, market researchers and the like. The focus is on high and knowledge processing like financial modeling, data analysis valuations etc.

### 3. Importance of Credit Rating Agencies

#### I. For the Investors

- It enables the investors to get superior information at low cost.
- It enables the investors to take calculated risk in their investment.
- It encourages the common man to invest his savings in corporate securities and get high returns.

#### II. For the Borrowers

- It facilitates companies with good rating to enter the capital market confidently and raise funds at comparatively cheaper rates.
- It can be used as a marketing tool.
- It facilitates foreign collaborations.
- It encourages discipline among the corporate borrowers.



## # Credit Rating Companies

The existence and development of credit rating companies largely depends upon their performance. Honest and impartial credit rating agencies would definitely thrive, as long as they sustain their credit.

### IV. For the Government

- Fair and good ratings motivate the public to invest their savings in company shares, deposits and debentures.
- It facilitates formulation of public policy guidelines on institutional investment.
- Credit rating system plays a vital role in investor protection without casting burden for that responsibility on the Government.

Comparison	GDR	ADR
Stands For	Global Depository Receipts	American Depository Receipts
Objective	Invest in Foreign companies Different countries	Invest in Foreign Companies
Purpose	Help acquire resources in different countries	Help acquire resources in the USA.
Issued in	European countries	The United States
Restrictions	Other countries	The USA
Currency	Euro currency	US Dollar
Access	Companies listed in LSE and Euronext	Companies listed in NYSE
Negotiation	All over the world	In America only



Liability	less as compare to ADR	legally more complicated
Market	Retail investor market Institutional Market	Retail investor market
Cost	High low	High
Meaning	GDR is a negotiable instrument issued by the international depository bank, representing foreign company stock trading globally.	ADR is a negotiable instrument issued by a US bank, representing non-US company stock, trading in the US stock exchange.

### 5) Functions of ADR Features of ADR

The features of ADR are briefly given here under,

- ADRs are denominated only in US dollars
- They are issued only to investors who are American residents.
- The depository bank should be located in US.
- The approval of Securities and exchange commission (SEC) of US needs to be obtained for issuing ADR.
- They are sub-classified on the basis of level of clearance made by SEC.



# Global Depository

A Global Depository Receipt also known as International depository receipt, is a certificate issued by a depository bank which purchase shares of foreign companies and deposits it on the account. GDR is an Important concept in the Indian Economy segment of the IAS Exam.

## Features of GDR

- \* It is a negotiable instrument and can be traded freely like any other security.
- \* GDR are issued to investors across the country. It is denominated in any acceptable freely convertible currency.
- \* The holder is entitled to dividends and bonus on the value of shares underlying the GDR.
- \* Under GDR, the issuing company transacts with only one entity for all its transactions.
- \* GDR is denominated in any foreign currency but the underlying shares would be denominated in local currency of the issuer.

## Process of Issuing GDRs

There are four steps in the process of issuing GDRs as follows,

- \* The company issuing GDRs hands over its shares to one domestic custodian Bank (DCB)



- \* The DCB requests the Overseas Depository Bank (ODB) situated in the foreign country for issuing the shares as GDR.
- \* The ODB converts the shares shown in rupee into GDR which are denominated in US dollars.
- \* Finally, ODB issues them to the intending investors.

## Characteristics of GDR

- \* It is an unsecured security
- \* A fixed rate of interest is paid on it
- \* It may be converted into number of shares
- \* Interest and redemption price is public in foreign agency
- \* It is listed and traded in the share market.

## Advantages <sup>of GDR</sup> to issuing company

- \* Accessibility to foreign capital market
- \* Increase in visibility of the issuing company
- \* Rise in the capital because of foreign investors

## Advantages of GDR to investors

- \* Helps in diversification hence reducing risk.
- \* More transparency since competitor's securities can be compared
- \* Prompt dividend and capital gain payments.
- \* GDR can be freely transferred.
- \* GDR saves the taxes of an investor. An investor would need to pay tax if he purchases shares in the foreign company, whereas in GDR same is not the case.



## Disadvantages of GDR

- \* Violating any regulations can lead to serious consequences against the company.
- \* Dividends are paid in domestic country currency which is subject to volatility in the forex market.
- \* It is mostly beneficial to High Net Worth Individuals (HNI) investors due to their capacity to invest high amount in GDR.
- \* GDR is one of the expensive sources of finance.
- \* There are no provisions for voting rights in GDRs.

## 1) Advantages of Credit Rating Agency

### # Professional Competency

A credit rating agency equipped with the required skills, competencies and credibility provides a professional service making it possible to use well researched and scientifically analyzed opinions regarding the relative ranking of different debt instruments according to their credit quality.

### # Easy to understand

Credit ratings are symbolic and are therefore easy to understand. The rating seeks to establish a link between risk and return.

### # Low Cost

The credit rating as provided by a professional credit agency is of significance not just for the individual small investors, but also for an organized institutional investor. It provides a low cost supplement to them in



the how appraisal system.

### # Efficient Practice

Credit rating serves as an effective tool for merchant bankers and other capital market intermediaries in the process of planning pricing, underwriting and placement of issue.

### # Effective Monitoring

Stock exchange intermediaries like brokers and dealers could use ratings as input for monitoring their risk exposure. Regulators in some countries specify capital adequacy rules linked to the credit rating of securities in a portfolio.

### # To Regulators

Credit rating has facilitated regulatory authorities around the world to issue mandatory rating requirement.

### # Systematic Risk Evaluation

For the efficient allocation of resources, a systematic risk evaluation is an essential requirement. Credit rating helps the corporate issuer of a debt instrument to offer every prospective investor the opportunity to undertake a detailed risk evaluation.

### # Index of Faith

Credit rating acts as an ideal index of faith placed by the market in the issuers. This eventually also acts as a guide for investment decisions.