IMPACT OF CREDIT RATING ON THE CORPORATE RATE OF INTEREST AND INVESMENT FLOW: A STUDY WITH REFERENCE TO SOME SELECTED INDIAN COMPANIES

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Introduction: Reduction of risk can increase the investment inflow (borrowing) or can decrease the cost of debt and both of these two factors are important to influence the value of the business. Among all the risk reducing devices of business, credit rating takes an important position. Credit rating is an evaluation of the credit-worthiness of an issuer of debts in general term or evaluation of credit-worthiness of a particular debt or financial obligation to a third party. The objectives of this study includes in the first place, testing if the corporate investment inflows (borrowing) really go high/low, as the case may be, corresponding to the credit rating being higher/lower and secondly, whether interest rates also go high / low corresponding to any lower / higher credit rating; thirdly and fourthly, whether there exists any change in investment inflow pattern and in interest rate after credit rating was made mandatory before the issue of debt instruments.

Research Methodology and Findings: In view of the aforesaid objectives, four suitable hypotheses have been framed and tested in the study. For the purpose of the study we have applied different statistical tools i.e. natural logarithm, correlation coefficient, linear regression model (by panel data methodology), paired t test (one-tailed), F statistic, Durbin Watson test, and R square tests. The study shows the following findings (corresponding to the four hypotheses):

(1) Interest rate is negatively affected by credit rating, which is a multiple of 0.25323 units plus a cross section effect. (2) Borrowing is positively affected by credit rating, which is a multiple of 1.9038 units plus a cross section effect. (3) There is no significant difference between the interest rates of pre- and post-credit rating periods. (4) Borrowings of post-credit rating are better for explaining corporate borrowings rather than the borrowings of pre-credit rating period.

Thus, the study clearly shows that a good credit rating helps one investor to enter into the market with confidence. Thereby, it definitely contributes to the general advancement of knowledge in this field.