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How Investor's decision changes due to change in Credit Ratings of a Bond.

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Abstract: This study examines the level of awareness of credit ratings among bondholders and its impact on their investment decisions. A sample survey was conducted (50 respondents) to assess their understanding of credit ratings and how it affects their investment behaviour. Overall, the research suggests that credit ratings are an important factor in investment decisions related to bonds. Investors should pay close attention to changes in credit ratings and adjust their investment portfolios accordingly.

Findings: The findings suggest that changes in credit ratings have a significant impact on investor behaviour, with downgrades leading to a halt in investment. The results indicate that while most bondholders are aware of credit ratings, their understanding of the meaning and significance of ratings varies significantly. Moreover, it was found that investors tend to react differently to credit rating changes depending on their investment horizons and risk preferences. The findings of this study have important implications for investors, bond issuers, and credit rating agencies.

***Index Terms* - Credit Ratings, Bondholders, Downgrades**

1. INTRODUCTION:

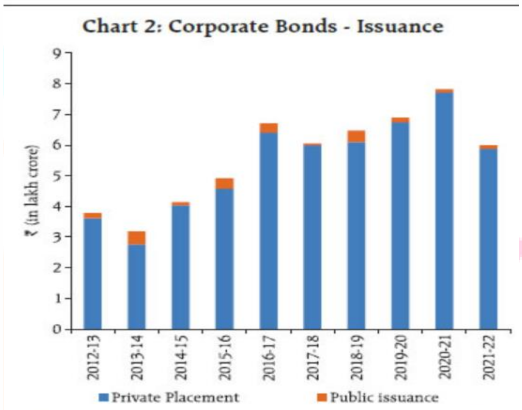
The bond market is a financial market where companies, governments, and other entities can raise capital by issuing bonds. Bonds are debt securities that represent a promise to repay the principal and interest to bondholders over a certain period of time. Bonds are a popular investment vehicle for investors looking to generate income and diversify their portfolios. Credit ratings are an important aspect of the bond market, as they provide investors with a measure of creditworthiness of bond issuers. Credit ratings are assigned by credit rating agencies such as Standard & Poor's, Moody's, and Fitch Ratings, in India ICRA, CARE and CRISIL are credit rating agencies. They assess the financial strength company issuing bond (bond issuer) and assign them ratings based on their ability to repay their debt obligations.

Credit rating agencies play a critical role in the bond market by providing investors with a measure of the creditworthiness of bond issuers. However, credit rating agencies have also faced criticism for their role in the global financial crisis of 2008, as some have argued that they failed to adequately assess the creditworthiness of certain issuers, leading to the collapse of the mortgage-backed securities market.

Overall, credit rating agencies are important players in the bond market and provide investors with a valuable service, but investors should also be aware of the potential limitations and biases of credit rating agencies when making investment decisions.

Economic Overview:

- The bond market size in India is around $1.8 trillion, with government securities accounting for $1.2 trillion and corporate bonds accounting for $0.6 trillion.
- The yield on a 10-year government bond rose by 13% to 7.61% in 2022, due to an increase in the repo rate from 4% to 6.25%.
- The yields from corporate bonds vary based on their credit ratings, with A-rated corporate bonds yielding 10% and above, AA-rated yielding 9% and above, and AAA-rated yielding 8% and above.
- The corporate bond market has been growing steadily over the years, with the outstanding stock of corporate bonds increasing four-fold from ₹10.51 lakh crore as at end of FY 2012 to ₹40.20 lakh crore as at end of FY 2022. During this period the annual issuance have increased from ₹3.80 lakh crore to close to ₹6.0 lakh crore.
- Overall, these trends suggest that the bond market in India is growing and becoming an increasingly important source of financing for both the government and corporations. However, the rise in yields on government securities and the impact of repo rate hikes on bond prices highlight the importance of monitoring interest rate movements and their effects on bond markets.



Meaning and Definition:

Credit ratings are important for bond investors because they provide an indication of the likelihood that the issuer will default on its debt obligations. Bonds with higher credit ratings are generally considered to be less risky, as the issuer is seen as having a stronger financial position and a lower likelihood of default. Bonds with lower credit ratings are generally considered to be riskier, as the issuer is seen as having a weaker financial position and a higher likelihood of default.

Changes in credit ratings can have a significant impact on the value of a bond. When the credit rating of a bond is downgraded, it generally indicates that the issuer's creditworthiness has declined, which can lead to a decrease in the value of the bond. Conversely, an upgrade in credit rating can lead to an increase in the value of the bond.

Overall, the bond market and credit ratings are closely intertwined, with credit ratings providing an important measure of creditworthiness for bond issuers and a critical factor in bond investing. Investors in the bond market should have a good understanding of credit ratings and their impact on bond values in order to make informed investment decisions that align with their investment objectives and risk tolerance

2. NEED OF THE STUDY:

- This study involves people residing in Mumbai and Navi Mumbai who are Bondholders. Hence the sample is a suitable set of people to study our research on. The scope of study is to understand how change in credit ratings of a bond can impact investors decision. Having a good understanding of credit ratings can be an important factor in making informed investment decisions related to bonds. It can help investors evaluate the risk-return trade-off of investing in a particular bond and make comparisons between different bonds and can help to anticipate changes in the creditworthiness of a bond issuer and adjust their investment portfolios accordingly.

- The credit rating of a bond is a critical factor in determining the level of credit risk associated with that bond, which in turn affects the investment decisions of bondholders. However, there is limited understanding of how changes in credit ratings impact investment decisions in the bond market.
- The problem addressed in this study is to analyse the impact of credit rating changes on investment decisions, including the magnitude of the impact and the factors that influence investor behaviour.
- This problem is of great significance for bond issuers, investors, and regulators, as it has implications for the pricing and risk management of bonds, as well as the overall stability of the bond market. Understanding the relationship between credit ratings and investment decisions can help stakeholders make informed decisions and develop effective strategies to manage credit risk in the bond market.

3. RESEARCH OBJECTIVES:

There are 4 objectives in performing this study which are as mentioned below:

1. To understand the impact of Credit Ratings on Bond Investment.
2. To find out the awareness regarding Credit ratings among investors.
3. To determine the impact of credit rating changes on investor behaviour and investment decisions.
4. To investigate the extent to which investors consider credit ratings when making investment decisions.

4. LIMITATIONS OF THE RESEARCH:

- Average number of Bond Investors are not taken as whole, rather they represent the average investors of a broking site (Zerodha).
- The study undertaken is based on primary data, with limited respondents. The sample size of 50 respondents may be too small to draw conclusions that can be generalized to a larger population.
- The sample of participants in a primary research study may not be representative of the population as a whole, leading to sample bias.
- The study was only conducted in Mumbai and Navi Mumbai, which may limit the applicability of the findings to other regions.

5. REVIEW OF LITERATURE:

1. **How credit rating change announcements affects corporate bond prices? Evidence from the post and during crisis period by Christos Chasiotis (2019)**
   the study examines that how change in credit rating announcements can have a significant impact on corporate bond prices. When a credit rating agency announces an upgrade or downgrade in the creditworthiness of a company, it sends a signal to investors about the perceived risk associated with the company's debt. This signal can lead to changes in demand and supply for the company's bonds, which can result in changes in bond prices. During the post-crisis period, evidence suggests that credit rating change announcements have had a stronger impact on corporate bond prices than during the crisis period. This is likely due to the increased awareness and scrutiny of credit ratings agencies following the 2008 financial crisis.

2. **Credit Ratings and Investment Decisions in Emerging Markets by Valentina Doneva, Jonathan Ström (03 June 2013)**
   The findings of this study suggest that credit rating changes have a minor impact on the investment decisions of companies in emerging markets, while factors such as firm size, interest rates, leverage, profitability, and inflation have significant effects on investment levels. The study also found that downgrades have a significant negative correlation with the cash flow level of firms in emerging markets.These results suggest that companies in emerging markets rely more on internal

funds and may not place as much importance on credit ratings as companies in developed markets. This may be due to a variety of factors, such as differences in institutional frameworks, market development, and investor sophistication.

3. **The impact of credit ratings on capital structure by Bora Aktan, Saban Celik (2019)**

   The results of this study suggest that changes in credit ratings have a significant impact on firms' financing decisions. Specifically, the study found that firms issue less net debt relative to equity following a change in the broad credit ratings level (e.g., a change from A- to BBB+). This may be due to the fact that changes in broad credit ratings levels signal a change in the overall creditworthiness of the firm, which may make it more difficult or costly for the firm to raise debt financing. In contrast, the study found that firms are less concerned with notch ratings changes (i.e., changes in credit ratings within the same broad credit rating level). This suggests that firms may be more focused on maintaining their overall credit rating level rather than specific notch ratings.

4. **The effects of credit rating grades' changes on capital structure: S&P 500 by Afef Feki Krichene, Walid Khoufi (2016)**

   The study's results suggest that real credit rating changes have a significant impact on firms' capital structure decisions. Specifically, the study found that both upgrades and downgrades of credit ratings affect leverage decisions in the following year. Firms that are downgraded to the speculative grade will reduce their debt issuance in the following year to reach again the investment grade, while firms that reach investment grade following an upgrade will increase their debt issues without fear of being downgraded again.

5. **Credit rating announcement and bond liquidity: the case of emerging bond markets by Amir Saadaoui and Mohamed Kriaa (2022)**

   The study examines the information content of bond ratings announcements and their effect on bond market liquidity. The study also investigates the impact of rating changes on sovereign bond liquidity around the rating announcements. The results suggest that rating changes can have a significant impact on sovereign bond liquidity, particularly for rating changes that move the bonds out of the investment grade category. These rating changes may elicit selling pressure or even fire sale of the fallen angels, which can lead to a decline in bond prices and a reduction in market liquidity.

6. **Credit rating and managerial behaviour in investment decision making: Evidence from the Korean market by Seoyeon Kim, Ephraim Kwashie Thompson and Changki Kim (march 2023)**

   The study suggests that the threat of a downgrade to speculative-grade provides managers with conservative investment decision incentives, and the greater the threat, the stronger the impact of investment-grade cut-offs. Overall, this study provides insights into how credit rating levels can impact firms' investment decision-making behaviour, and how investment-grade cut-offs can affect managerial behaviour. These findings may be useful for firms, investors, and policymakers in understanding the implications of credit ratings for firms' investment decisions.

7. **Understanding and Use of Credit Rating in India: A Survey of Individual and Institutional Investors BY Ranadev Goswami and S. Venkatesh (March 1939)**

   This paper examines investors' awareness, perception, understanding level, and usage of credit rating in the Indian financial market through a questionnaire-based sample survey covering individual as well as institutional investors. The study finds that there is a high diffusion of rating usage among all classes of investors. However, there is a perceptible disenchantment with the reliability of ratings, propensity of subsequent downgrading, and timeliness of rating surveillance. The study also reveals that institutional investors possess superior knowledge and understanding about ratings than individual investors. Thus, the study emphasizes the need for rating agencies to work on educating the common investors to propagate proper understanding and usage of credit rating.

8. **Empirical Research on Corporate Credit-Ratings: A Literature Review by Alexander B. Matthies (2013)**

   The Research paper examines the correlation between credit ratings and corporate default rates has been extensively studied, and the results consistently show that lower credit ratings are associated with a higher likelihood of default. This finding has important implications for investors and lenders who use credit ratings to assess the risk associated with lending or investing in a particular company. The influence of credit ratings on capital markets has also been studied, with researchers finding that changes in credit ratings can have a significant impact on stock prices, bond yields, and other market indicators. This suggests that credit ratings are an important factor in the allocation of capital and that investors and lenders rely on ratings to make investment decisions.

9. **Consistency in the Bond Rating Methodology – A Study of Indian Credit Rating Agencies by Archana H N & S Jayanna (2016)**

   This study highlights the use of quantitative factors (ratios) in credit rating methodology and their internal and external consistency. The sample included 132 bonds rated by four credit rating agencies in India between 2008-09 to 2014-15. The study used one-way ANOVA and Tukey Honest Significant Difference analysis to assess the consistency of the bond rating methodology within and across the group. The findings of the study suggest that the bond rating methodology within the group is consistent and across the group is also found to be consistent. This implies that the ratios used by credit rating agencies may not be able to effectively discriminate between different grades of creditworthiness.

10. **EFFECTS OF BOND'S INTEREST RATE, RATING AND MATURITY TIME TOWARD BOND'S YIELDS by Mega Ayu and Widayat (2019)**

    This study aims to investigate the effect of interest rates, bond rates, and maturity time of bond yields on property and real estate companies listed on the Indonesia Stock Exchange from 2013-2018. The research is associative and uses a quantitative approach. The population of the study is property and real estate companies, and the sampling technique is purposive sampling. Thirteen companies and 38 bonds are selected as the research sample based on the current criteria. The findings of this study suggest that interest rates and maturity time have a positive impact on bond yields, while bond rating has a negative impact. This information can be useful for investors in property and real estate companies in Indonesia to make informed investment decisions based on the current interest rates, bond rates, and maturity time.

6. RESEARCH METHODOLOGY:

6.1 Research Design: In the present study, both Exploratory Research Design and Descriptive Research Design have been used to study the research paper titled "Impact of Credit Ratings on Investment decision of a Bondholder".

Research Instrument: Research Instrument used in this Research paper are Qualitative and Quantitative Research Method.

Sampling Method: The sample size of 50 respondents was collected from investors who invest their money in bonds. In this research paper sampling method that is used is Convenience Sampling.

Research Area: The responses were collected from Mumbai and Navi Mumbai.

Sampling Size: It specifies the number of samples (50) online were chosen from a target population of Bondholders who have knowledge and experience in the field.

6.2 Data and Sources of Data-

There are two main sources of Data collection in research: Primary and Secondary Sources.

Primary Data:

Primary data is collected via questionnaire by framing a structured set of questions based on above mentioned Research Objectives. Questionnaire was circulated online and it is used to collect information from respondents about their knowledge, opinions, beliefs, or experiences related to the Research topic. Data Interpretation, Hypothesis and Findings is done on the basis of results obtained via Questionnaire.

Secondary Data: The secondary data was gathered by looking through Review of Literatures, Articles and subject-related information. Data regarding Economic impact was collected from RBI website, Economic times, The Financial express, Business Today and Mint. All the Data regarding Economic Impact was gathered through above mentioned verified sites.

6.3 Theoretical framework-

This study involves three main variables, namely: Bondholders, Impact of Credit Ratings and Investment decision.

6.4 Statement of Hypothesis and testing-

Z Test method is used to test the hypothesis.

Formula: $Z = (M - \mu) / \sqrt{(\sigma2 / n)}$

Hypothesis 1-

H0: There is no significant change in investment decision due to change in credit ratings.

H1: There is a significant change in investment decision due to change in credit ratings.

(Total Number of Respondents 50)

Questions:		**Hold**	**Sell**	**Buy**	**Total**
What will you do when the Credit Ratings of your bond is going down?		24	21	5	50
		Yes	**No**		**Total**
Have you ever considered investing in bonds with lower Credit Ratings for potentially higher returns?		35	15	-	50
Total		59	36	5	100

Hypothesis Testing:

Hypothesis of study is tested using Z Test Method

Formula: $Z = (M - \mu) / \sqrt{(\sigma2 / n)}$

Population Mean (μ)	30
Population Variance ($\sigma2$)	127.46
Sample Mean (M)	39
Sample Size (N)	50
Level of Significance	0.05

(Calculation of Sample mean and standard deviation (σ=11.29) is done through Excel)

Results:

Z Score Calculations

$Z = (M - \mu) / \sqrt{(\sigma2 / n)}$

$Z = (39 - 30) / \sqrt{(127.46 / 50)}$

$Z = 9 / 1.59662$

$Z = 5.6369$

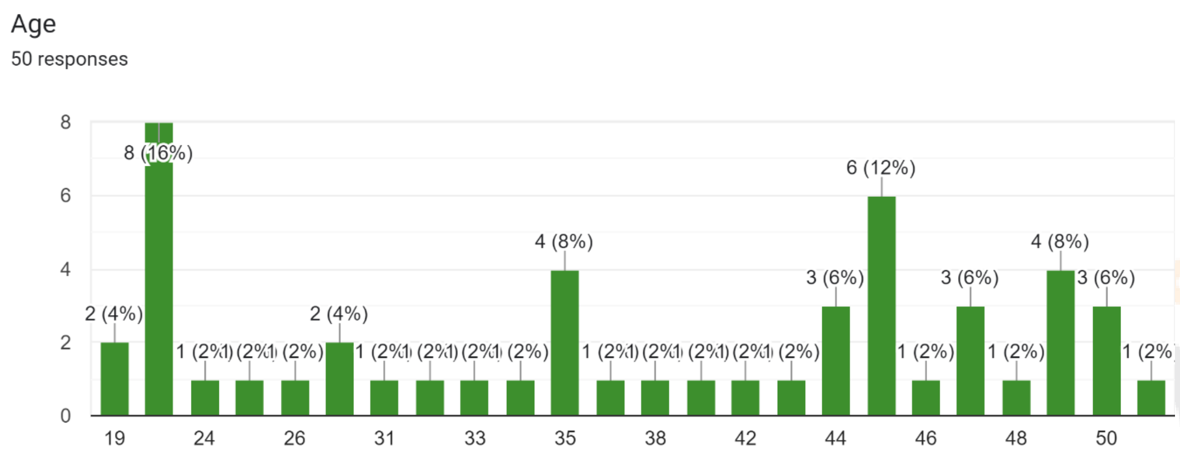
Conclusion:

- Since, p – value is less than level of significance.
- The value of z is 5.6369. The value of p is < .00001. The result is significant at $p < .05$.
- Therefore, Null Hypothesis is rejected and Alternative Hypothesis is accepted.
- So, there is a significant change in investment decision due to change in credit ratings

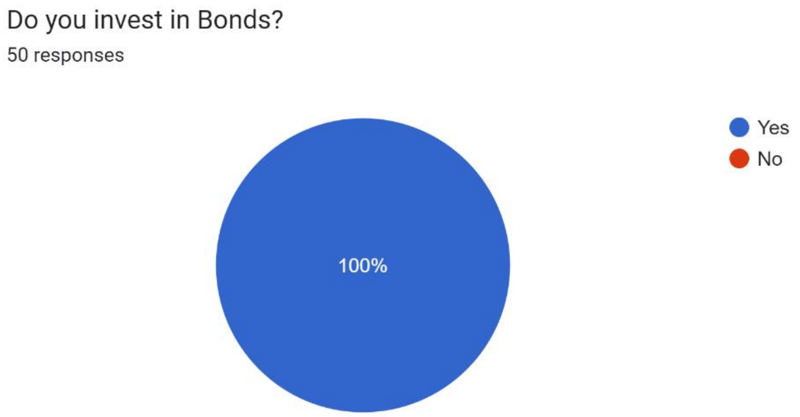
7. DATA ANALYSIS AND INTERPRETATION:

Data Analysis:

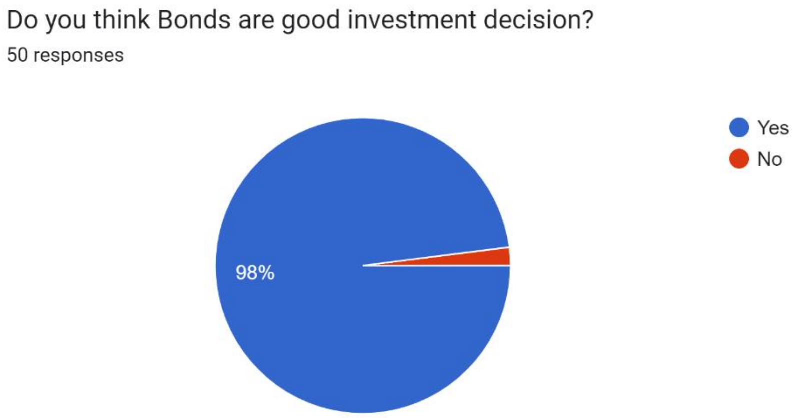
Based on the Primary data collected through the Questionnaire from 50 respondents who invest in bonds. The data collected was analyzed through pie charts, graphs and hypothesis testing using statistical tools.



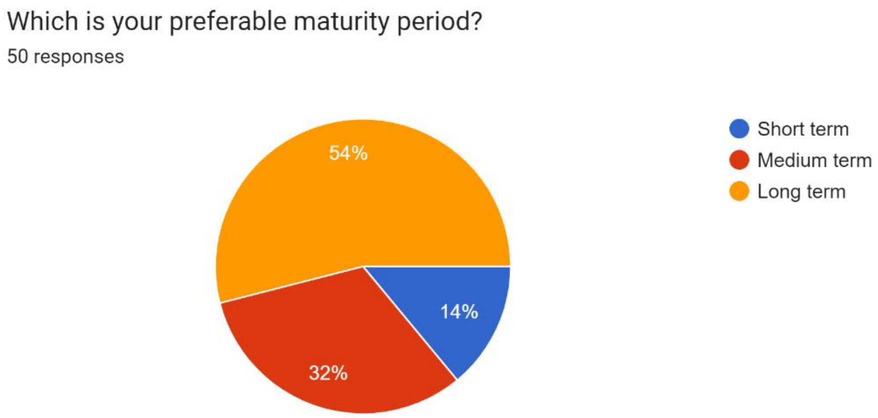
- The responses were collected from a range of respondents between the ages of 19 and 62 to have a diverse range of perspectives on the given topic.
- From the above chart we can conclude that 75% that is Majority of Respondents are above the age of 30 (37 respondents). Which is also an average age of bond investors in India according to Zerodha's site.
- It is positive to see those 13 respondents (26%) between the ages of 19 - 26 have awareness regarding credit ratings and its impact, and that they are investing in bonds. This suggests that there is participation and awareness among young people in the bond market, which is a good sign for the future.



Analysis: The above chart shows that 100% (50) respondents from our survey tend to invest their money in bonds. Therefore, we can say that the selected respondents are suitable for the survey.

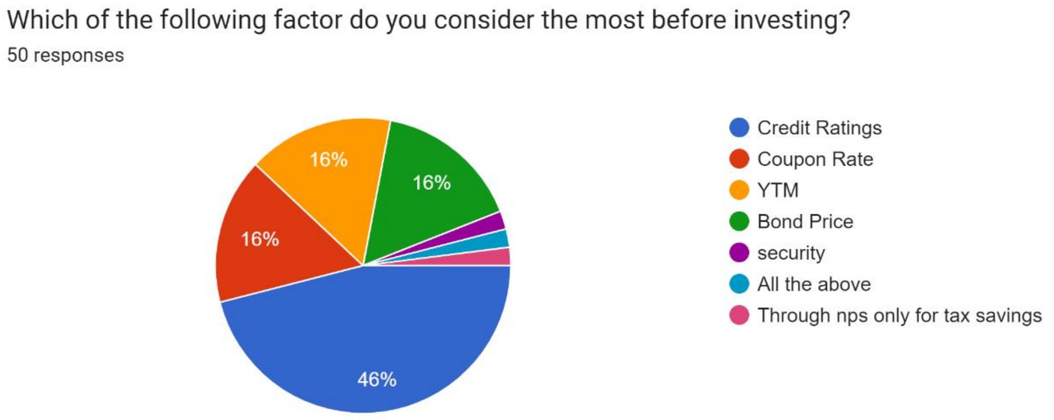


Analysis: 98% (49) of the respondents have responded positively and they think that bonds are good source of investment.



Analysis: When the respondents were asked their preferable maturity period:

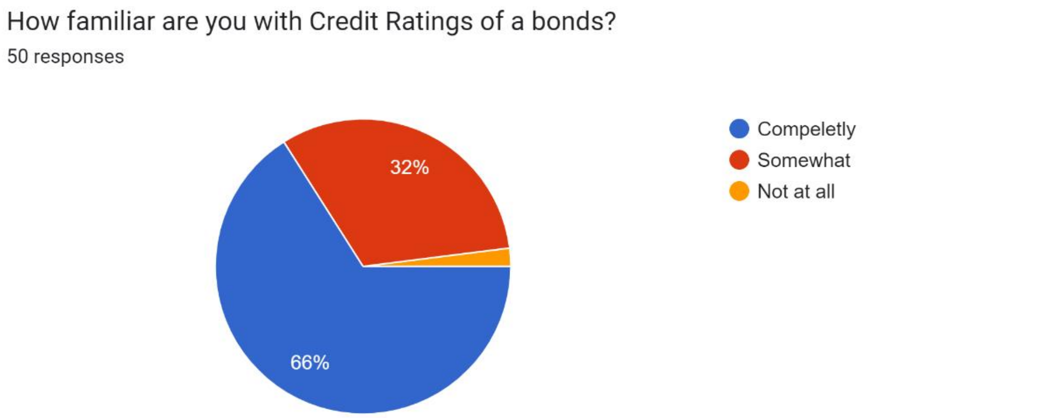
- 14% (7) respondents selected short term as their preferable maturity period.
- 32% (16) respondents selected medium term as their preferable maturity period.
- 54% (27) Majority of the respondents selected long term as their preferable maturity period to invest their money.



Analysis: When respondents were asked regarding which of the above-mentioned factor would they consider the most before investing:

46% (23) respondents considered credit ratings as a key factor in their investment decisions. However, remaining respondents do not rely solely on credit ratings to make investment decisions, but rather consider a range of factors including the Coupon Rate (16%), YTM (16%), Bond price (16%)

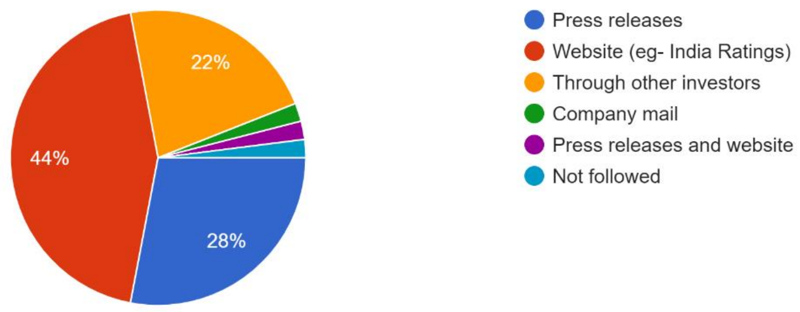
An option of others was also given to understand a different aspect. 2% (3 respondents) respectively said that they select Security, Tax Saving and All the above- mentioned factors before making an investment decision.



Analysis:

- 66% (33 respondents) are completely aware regarding the concept of credit ratings of a bond.
- 32% (16 respondents) are somewhat familiar with the term. It indicates that they have some level of understanding but may require further education or information to fully comprehend its implications for investment decisions.
- 2% (1 respondent) are not familiar with the concept of credit ratings of a bond, it may indicate that they have limited experience or knowledge in bond investing or financial markets in general.

How do you stay informed about the Credit Rating changes for the bond you have invested in?
50 responses

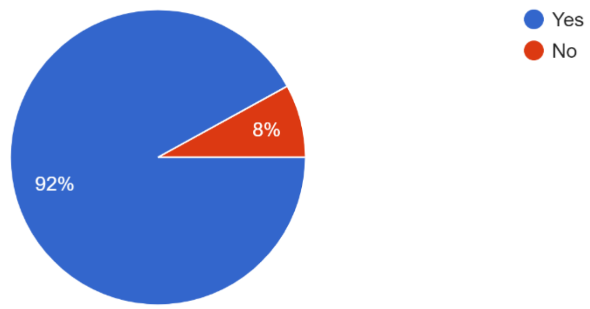


Analysis: When respondents were asked how do they stay informed regarding credit rating changes:

- 44% (22 respondents) said that they stay informed through Website (e.g.- India Ratings)
- 28% (14 respondents) stay informed through Press Releases.
- 22% (11 respondents) stay informed through other investors.
- Few stays informed through Company mail as well.

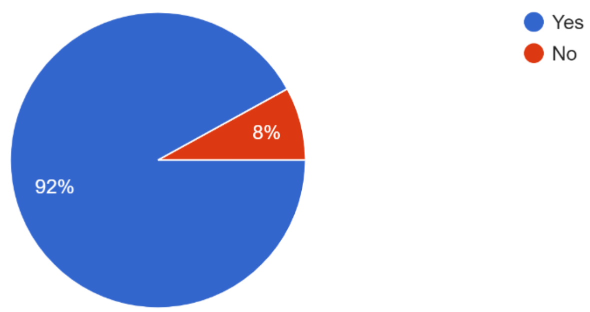
It suggests that they are actively seeking out information and are taking steps to stay informed about changes that may impact their bond investments.

Do you understand how changes in credit ratings can affect the value of a bond?
50 responses



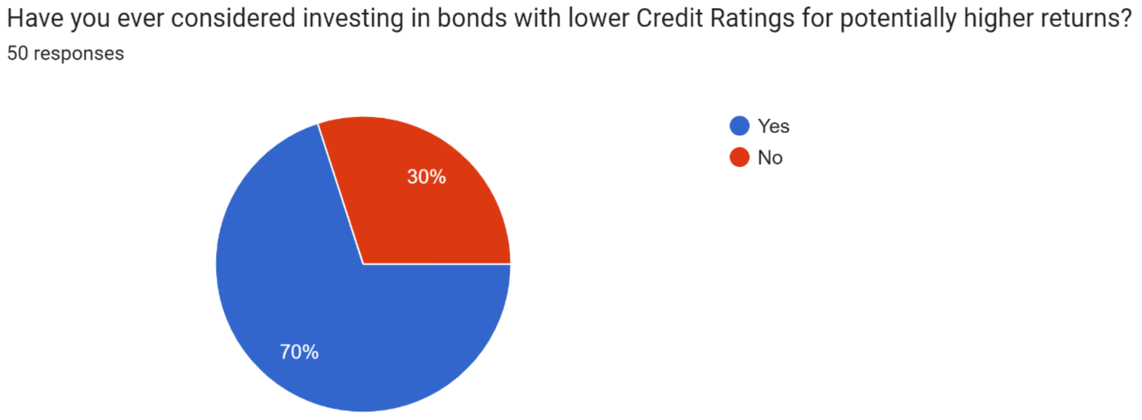
Analysis: The above chart shows that 92% (46 respondents), Majority of respondents understand how changes in credit ratings can affect the value of a bond, it suggests that they have a good understanding of the risks associated with bond investing.
For the 8% (4 respondents) who do not understand how changes in credit ratings can affect the value of a bond, it is important for them to seek further education and resources to improve their understanding of bond investing.

Are you aware how Interest rate changes with respect to change in Credit ratings of a Bond?
50 responses

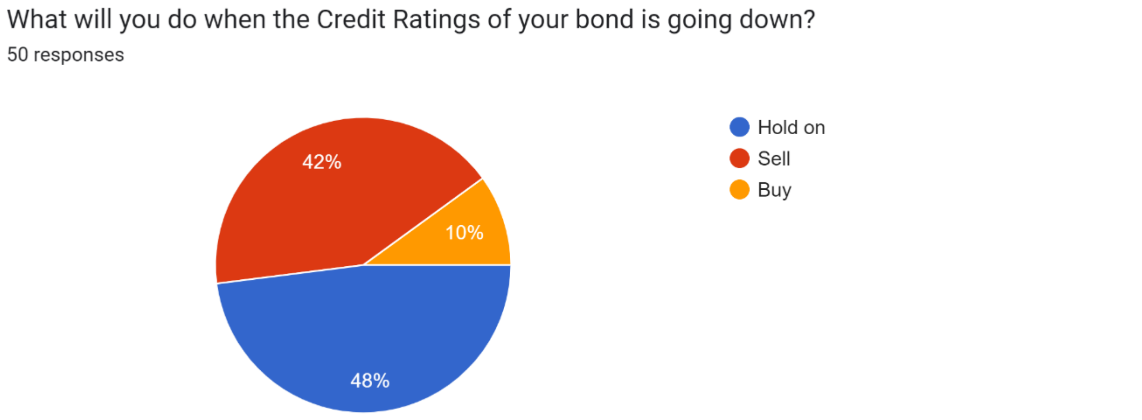


Analysis: When respondents were asked that are they aware how Interest rate changes with respect to change in Credit Ratings of a bond:

- 92% (46 respondents), Majority of bondholders have said that they are aware of how interest rate changes with respect to change in credit ratings of a bond, it suggests that they understand the relationship between credit risk and interest rates.
- 8% (4 respondents), those who are not aware suggests that they may have limited knowledge or experience in bond investing.



Analysis: The above chart shows that 70% (35 respondents), Majority have said that they have considered investing in bonds with lower credit ratings for potentially higher returns, it suggests that they are willing to take on higher levels of risk in pursuit of greater rewards.



Analysis: When bondholders were asked what would they do if the credit ratings of their bond was going down:
48% (24 respondents) The Majority said that they would hold on to their bond, while 42% (21 respondents) said they would sell it and 10% (5 respondents) said that they would buy more.
This response may indicate that bondholders have different risk preferences and investment goals, and respond differently to changes in credit ratings.

1. **FINDINGS:**

- Majority of respondents are completely familiar with the concept of credit ratings of a bond; it indicates that they have a good understanding of the creditworthiness of a bond issuer and the associated risks and rewards of investing in a particular bond.
- When respondents were asked regarding their preferable maturity period, The majority of respondents have preference for long-term maturity periods for bonds, may be driven by a combination of factors, including higher returns, stability, diversification, inflation protection, and liquidity.
- Bondholders who choose to hold on to their bond may do so because they believe that the bond issuer will be able to weather the downgrade and continue to make timely interest and principal payments. They may also believe that the bond's

yield is attractive and compensates them adequately for the risk associated with the downgrade. On the other hand, bondholders who choose to sell their bond may do so because they believe that the credit downgrade is a signal of increased default risk, and they wish to avoid the risk of a potential default. They may also believe that the bond's price will decline further, and they wish to sell before the price drops too much.

- Investors who are considering investing in lower-rated bonds could because of higher yields. Bonds with lower credit ratings generally have higher yields as compensation for the increased risk of default.

2. CONCLUSION:

It can be concluded that credit ratings are an important consideration for investors when making investment decisions. The research found that a significant majority of investors pay attention to credit ratings when evaluating bond investments, and many investors reported that they would change their investment decisions if a bond's credit rating were to change.

The research also found that there is a general awareness among investors about the role of credit ratings in the investment decision-making process, although there were some variations in awareness levels among investors.

Overall, the research suggests that credit ratings play an important role in shaping investment decisions, and that investors are generally aware of the significance of credit ratings. These findings can have implications for bond issuers and credit rating agencies, as they highlight the importance of maintaining high-quality and reliable credit ratings to ensure investor confidence in the bond market.

3. ACKNOWLEDGMENT:

I would like to express my deepest gratitude to all those who have contributed to the completion of this project. Firstly, I would like to thank my professor Ranu Jain for providing me with guidance and support throughout the entire process. Her expertise and insight have been invaluable in shaping the direction of this project.

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I would like to thank my family and friends for their unwavering support and encouragement throughout this project. Their patience and understanding have been a source of strength for me.

Once again, I would like to extend my sincerest thanks to all those who have contributed to this project.

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Annexure:

How investor decision changes due to change in Credit Ratings

I am a student of Bombay Stock Exchange ltd. Conducting this questionnaire as a part of Business Research project on the topic "Impact of Credit Ratings on Bond Investments". This questionnaire is conducted with the purpose to understand how investors investment decision is influenced by the Credit Ratings of a Bond.

Request you to read the following questions and select the option that you can relate to the most. Please note all the information you enter here is for my research purpose only and the information will be kept confidential.

*Required

1. Name *

____

2. Age *

____

3. Gender *

Mark only one oval.

◯ Male
◯ Female

4. Do you invest in Bonds? *

Mark only one oval.

◯ Yes
◯ No

5. Do you think Bonds are good investment decision? *

Mark only one oval.

- Yes
- No

6. Which is your preferable maturity period? *

Mark only one oval.

- Short term
- Medium term
- Long term

7. Which of the following factor do you consider the most before investing? *

Mark only one oval.

- Credit Ratings
- Coupon Rate
- YTM
- Bond Price
- Other: ____________________

8. How familiar are you with Credit Ratings of a bonds? *

Mark only one oval.

- Compeletly
- Somewhat
- Not at all

9. How do you stay informed about the Credit Rating changes for the bond you have invested in? *

Mark only one oval.

- Press releases
- Website (eg- India Ratings)
- Through other investors
- Other: ______________

10. Do you understand how changes in credit ratings can affect the value of a bond? *

Mark only one oval.

- Yes
- No

11. Are you aware how Interest rate changes with respect to change in Credit ratings of a Bond? *

Mark only one oval.

- Yes
- No

12. Have you ever considered investing in bonds with lower Credit Ratings for potentially higher returns? *

Mark only one oval.

- Yes
- No

13. What will you do when the Credit Ratings of your bond is going down? *

Mark only one oval.

- Hold on
- Sell
- Buy
- Other: ____________________