CHAPTER 2 : THEORY DEFINITION

The complexity of business transactions today differs from that of the past, where most transactions were basically straightforward and simple in nature. Setting up a business was somewhat organised through the business owner's social network, where finances, experience, etc. was sought. Social networking was the primary driving force behind the setting up of businesses, where it was the either the family or friends or even both who provided finances. The process was thus simplified and results in very little financial burden for the entrepreneur. However, these days, with the advent of complexity in businesses, as well as the requirement for larger capital, banks have begun to monopolise the financing. Though the processes of obtaining finances are stringent, borrowings of this nature has brought about more professionalism in the business as banks ensure only viable ventures are financed.

As with many other facets of business, ownership of businesses too saw changes. From single ownership, some organisations evolved into public limited companies, where the task of shaping and directing the organisation was assigned to a group of individuals who represented interests of parties holding ownership of the organisation. This "board of directors" may be shareholders themselves, representatives of shareholders or otherwise professionals who are "recruited" to shape the direction of the organisation.

Evolution did not spare the source of funds. Funds that traditionally originated from sources within the business circle soon saw funds being derived from the public, made possible through public listing of companies. Further to this, globalisation tore down financial borders and enabled funds to flow from all corners of the globe.

Credit rating thus became a necessary tool for investors and borrowers alike. It enabled the investors to have the "measurement" to gauge their investment viability and the borrowers in turn benefit from this rating to achieve their aim. Rating agencies, which carry out credit rating provide for investors ratings that are objective and independent, thus eliminating the element of biasness. The ratings are derived from a variety of factors, such as financial ratios, mortgage provisions, maturity, stability, regulations, anti-trust, overseas operations, environmental factors, product liability, pension liabilities, labour unrest, accounting policies, subordination provisions, guarantee provision, sinking fund, etc. The ratings are expressed in alpha or alpha- numeric symbols with plus or minus signs in descending order. Basically, it is creditworthiness assessment of a borrower reflecting the probability of default on the debt instrument taking into account the present and future relative risks involved.

The rating basically works as a grading element, where investors would be able to gauge the worthiness of investment. The higher the grading, the more secured one's investment is. For the borrower, a higher rating enhances his chances of attracting funds and this could be achieved with a lower cost as well. The rating is practically a creditworthiness report to classify the viability of an organisation which is sometimes used in other areas of businesses as well, such as ability to obtain leases on more favourable compared with those who have a lower rating grade.

Though ratings may be well established and fully developed in overseas countries, in Malaysia, this form of ratings is still very much new and in its developmental stages. Rapid growth in the private debt security market in relation to issues and value precipitated the need for transparency and confidence building in the market. It also protects the interests of the investing community and provides a safe investment climate in the country.

2.1 Areas presently rated by RAM

Financial Institution – this covers financial institutions such as banks, financial institutions, brokerages, etc.

Corporate debt – involves short and long term papers issued by business units

Islamic debt – based on murabaha an al-bai bithamin al-ajil, this is a fast growing debt instrument.

Senior debt – covers all senior debt that have prior claims over all other debt of business unit.

Claims paying ability or CPA – covers the insurance fraternity on its abilities to meet obligation to policy-holders as they become due.

The process of rating assessment is by no means a simple and straightforward one. Initially, a review is made of the issuers. This is done through documents submitted to it by the issuers. This is followed by meetings with the senior management team through which relevant information are gathered. It also gives the rating agency the opportunity to pose questions that may be crucial in determining the ratings. Once a rating is decide upon, the client reserves the right to accept the rating or otherwise. In the event, it is dissatisfied with the rating decision it reserves the absolute right to appeal against it, citing reasons and justifications for its rejection of the ratings. The appeal is reviewed by the Rating Committee, which decides on the appeal. On the other hand, should the rating be acceptable to the client, it (the rating) will continuously be monitored until maturity. Once ratings are finalised, it is communicated to KLSE and to the public through the print media.

Ratings are subject to continuous review due to the ever-changing business climate, which may affect an organisation favourably or otherwise. As many parties rely on these ratings in many business transactions, it is quite imperative that the ratings reflect the true nature of business integrity and climate.