

A STUDY ON RISK AND RETURN RELATIONSHIP OF NON-CONVERTIBLE DEBENTURES OF SELECTED COMPANIES IN INDIA

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ABSTRACT

A Non-Convertible Debentures (NCD) is a debt instrument with an initial maturity of up to one year that is issued through private placement by a company, including Non - Banking Finance Corporations (NBFCs), to raise money. NCDs are considered to be debt and cannot be converted into equity. An NCD's interest rate is set by the firm that issued the NCD. Companies raise money through NCDs for meeting of working capital needs, long term debt repayment, expansion ambitions, and other general corporate goals. Typically, the investment vehicle offers a greater interest rate than fixed bank deposits. In India, SBI, the largest lender in the nation by assets, offers a 6.75 percent return on fixed deposits held for five to ten years. Interest rates on NCDs typically range from 8 to 12 percent per annum. NCDs are required to get ratings from at least one credit rating agency. This provides investors with information about the issue's level of safety. The offer paper must include information on the rating and exactly what it represents. Even if the issuer does not agree with any of the ratings, if the NCD has received ratings from more than one agency, all of the ratings must be published. The company's financial situation can be determined in part by looking at its credit rating. Investors that like steady profits with less risk may wish to think about investing in NCDs. Along with adding the security of fixed income, the instrument can assist diversify the portfolio. If held until maturity, interest from non-convertible debentures is included in income and subject to the applicable income tax rate. According to the risk-return trade-off, the reward increases with risk and vice versa. Based on this theory, low levels of uncertainty correspond to low potential returns, whereas high levels of uncertainty correspond to high potential returns. The risk-return trade-off states that investing money can only result in bigger returns if the investor is willing to endure a higher likelihood of losses. In order to demonstrate the influence on the risk and return trade-off, specific organisations were chosen for the study on the relationship between risk and return and non-convertible debt at this period. As such, this paper makes an attempt to find out the risk and return relationship of NCDs of selected companies in India.

Keywords: Non-Convertible Debentures, Risk, Return, Beta value and maturity

INTRODUCTION

Non-convertible debentures (NCDs) are fixed-income securities typically offered to the public as a means of generating long-term capital gains by highly rated corporations. Compared to convertible debentures, they offer somewhat higher interest rates. Debentures that are not convertible come into this group. They cannot be changed into stocks or equity. NCDs have a

fixed maturity date, and depending on the fixed term stated, the interest can be paid in addition to the principal amount either monthly, quarterly, or annually. When compared to convertible debentures, they provide investors superior yields, liquidity, low risk, and tax advantages. Further the capital appreciation of fixed income securities are distinct dream. It will arise or not is based on the availability of Interest rate risk. As such, this paper makes an attempt to find out the risk and return relationship of NCDs of selected companies in India.

STATEMENT OF THE PROBLEM

To understand how certain investors select the tactics they do, it is essential to comprehend the relationship between risk and return. The first is the presumption that risk and profit cannot coexist. The greater the likelihood that an investment would lose money, the greater the potential that it will generate a big return. The possible return on an investment will also be lower the lesser the risk it entails.

The second precept states that if an investor can receive a higher-than-average return on an investment with less risk, they may be willing to forego a potentially higher return in order to avoid a higher level of risk. It can occasionally occur when interest rates rise. Investors favour bonds over equities because of the reduced risk and less erratic pricing of bonds. This makes stocks riskier because of how quickly and frequently their prices change. This is justified by the fact that they are increasing their protection against prospective loss while sacrificing nothing in the way of potential gain. The third tenet holds that an investor can balance risk and return across their whole portfolio by making investments at various risk levels, from the highest to the lowest. It is feasible for some investments to create significant returns while others ensure the security of a portion of the principal by diversifying the portfolio in this way. Diversification, lower risks, a steady stream of income, and returns on NCDs are a few factors that explain why investing is so important. Non-Convertible Debentures are subject to credit, interest rate, and liquidity risks. These factors led the researcher to determine that it was essential to attempt the study on NCDs.

REVIEW OF LITERATURE

Rahul Moolbharathi and Tukaram Sugandi (2021) in their article emphasised the need for deliberate market investment in the current environment of high stock market volatility. It is imperative to have a better comprehension of the statistical tools and their metrics for better decision making given that many investors from the millennial generation are betting on the market with their investments and anticipating a significant return from the stock market. To better understand how the stocks move in relation to the market, this study measured the risk and return of various stocks using their respective benchmark indices. Any investor's single goal in the market is to maximise profit while minimising risk. The paper aids the investor in this regard by providing an overview of the numerous statistical tools that can be used to evaluate the risk and return of the stocks. To understand how the risk and return are different for each sector and to identify which sector is suited for investment in terms of risk and return,

the study compared index performance to benchmark index using a variety of statistical methodologies.

Suneela Bharathi. P. (2019) According to them, Non-Convertible Debentures are fixed income long-term securities issued by highly rated firms, and they have higher coupon rates than convertible debentures. Credit rating firms will issue companies ratings based on their credit worthiness and prior financial performance, which helps investors make informed investment decisions. In order to grade corporate companies, credit rating organisations use a particular approach, which is examined in this essay.

Subramanyam and Nalla Bala Kalyan (2018), their study's primary goal is to inform potential investors about mutual fund investing and persuade them to place their money where they can earn the most return on their investment. The study offered an intriguing look at investor knowledge of mutual funds, their capacity for accepting calculated risks, and their preferred investing options, among other things. The Indian Capital has grown significantly during the past few years.

The economy has been opened up as a result of financial sector reforms, public sector reforms, investing policy reforms, and economic reforms, and there have been several advancements in the Indian money market and capital market. The mutual fund industry has grown to play a significant role in helping small investors. This study aids in our understanding of how businesses diversify in order to increase returns and reduce risks by operating in a variety of industries and businesses.

OBJECTIVES OF THE STUDY

1. To find out the relationship of Fixed Income securities with risk free rate in Indian NCDs.
2. To analyze the relationship between the risk and return of Non-Convertible debentures of selected companies in India.
3. To evaluate the significant impact of Non-Convertible Debentures in India.

METHODOLOGY

Research Design

The present investigation entirely relies on secondary data. Researchers have gathered information about NCDs from reliable sources and the official RBI website. The corporations with highest safety bond ratings were used as the foundation for the data collection. The Highest safety grade stands for bonds with a high level of creditworthiness since their issuers can easily satisfy their financial obligations and have the lowest default risk.

Period of the Study

The selected companies were divided into five different categories, including those for maturity up to three years, maturity up to five years, maturity up to seven years, maturity up to ten years,

maturity up to fifteen years and above fifteen years. As a result, interest rates from a few chosen companies were obtained during a 15-year period.

Tools and Techniques Used

The bonds issued by various corporations were examined and assessed using the actual bond rate, the risk-free rate of return, simple percentage analysis, beta valuation, the Sharpe Model, the Treynor's Model, and the Jensen Index.

LIMITATIONS OF THE STUDY

- i. The researcher only took into consideration bonds with a Highest safety grade and ignored other sets of assets.
- ii. Investors returns are taken after Income tax rate at 20% per annum.
- iii. The study concentrated on the interest rate, risk, and return of chosen companies, but did not take into account one company's portfolio investment.
- iv. Since the study was restricted to non-convertible debentures, it cannot be applied to other instruments.

ANALYSIS AND INFERENCES

I. Simple Percentage Analysis

Table 1: Calculation of Additional return earned by NCDs with different maturity periods (After Tax in Percentage)

S.No.	Company Name	Upto 3 years	Upto 5 years	Upto 7 years	Upto 10 years	Upto 15 years	Above 15 years
1	Power Finance Corporation Ltd	1.70	1.504	1.448	1.264	1.704	1.84
2	National Highways Authority of India	NA	1.264	1.264	1.344	1.32	1.504
3	Indian Railway Finance Corporation Ltd	NA	1.664	1.256	1.184	0.576	1.624
4	Infrastructure Development Finance Company Ltd (IDFC)	1.66	1.2	1.112	0.608	NA	NA
5	Rural Electrification Corporation Ltd	0.46	1.224	1.112	0.576	1.6	1.4
6	India Infrastructure Finance Company Ltd	1.22	1.448	0.16	1.312	1.408	1.704
7	Jawaharlal Nehru Port Trust	NA	NA	0.16	1.536		1.712
8	National Housing Bank	NA	NA	1.248	1.688	1.608	1.64
9	National Hydro Electric Power Corporation Ltd (NHPC)	NA	2.104	1.632	1.744	1.736	1.832
10	Non-Technical Popular Categories Ltd (NTPC)	NA	NA	1.232	2.264	1.488	1.744
11	Indian Renewable Energy Development Agency Ltd	NA	NA	2.304	13.52	1.544	15
12	State Bank of India	2.66	10.408	12.928	1.264	NA	NA

Source: Secondary Data

Table 1 represents the calculation of Additional return earned by the investors in NCDs using simple percentage analysis with different maturity periods. As per the table the higher amount

of additional return was secured by State Bank of India with 2.66%. The result was derived by considering the Offer rate of Interest of NCDs after tax rate and risk free interest rate after tax rate. State Bank of India securities holds the highest pay back return with 10.408% and 12.928% with the maturity period of 5 years and 7 years. In case of 10 years maturity Indian Renewable Energy Development Agency Ltd holds the highest position with 13.52% National Hydro Electrical Power Corporation Ltd secured first position in providing highest additional return with the maturity period of more than 10 years. Indian Renewable Energy Development Agency Ltd retains the highest position of paying additional return to the investors with the score of 15% in case of NCDs having more than 15 years of maturity period. Overall the payback of additional return to the investors is quiet good in all the maturity periods of NCDs.

II. BETA VALUATION, SHARPE, TREYNOR AND JENSEN RATIO:

Table 2: Calculation of Beta, Sharpe Ratio, Treynor Ratio and Jensen Ratio on NCDs with maturity period 2 years to 3 years

S.No.	Company Name	Bond Rate	Risk Free Bond Rate	Difference 2
1	Power Finance Corporation Ltd	8.75	6.62	4.5369
2	Infrastructure Development Finance Company Ltd (IDFC)	8.7	6.62	4.3264
3	Rural Electrification Corporation Ltd	7.19	6.62	0.3249
4	India Infrastructure Finance Company Ltd	8.15	6.62	2.3409
5	State Bank of India	9.95	6.62	11.0889
		42.74	33.1	22.618
	Standard Deviation (σ)	1.216		
	$\sigma = \sqrt{(\sum (R - R_{\bar{}})^2/n)}$	1.2167		
	β	0		
	Sharp Ratio	15.3846		
	Treynor Ratio	0		
	Jensen Ratio	0		

Source: Secondary Data

Table 2 represents the calculation of Risk and return relationship with selected NCDs which are holding maturity period of 2 years to 3 years. The Standard Deviation calculated for the selected NCDs is 1.216. A beta value that is less than 1.0 means that the bond value is theoretically less volatile than the market. As per the table Beta value represents 0 for the NCDs having maturity of 2 to 3 years which means it is safe to invest in the above-mentioned bonds. Sharpe ratio is positive with the value of 15.384 represents the investment return is greater than the risk-free rate. The higher the Sharpe Ratio, the greater risk-adjusted-performance. Since the Beta value is 0 Treynor Ratio and Jensen Ratio also represents 0 with the funds having maturity period of 2 to 3 years.

Table 3: Calculation of Beta, Sharpe Ratio, Treynor Ratio and Jensen Ratio on NCDs with maturity period of 5 years

S.No.	Company Name	Bond Rate (%)	Risk Free Bond Rate (%)	Difference 2
1	Power Finance Corporation Ltd	8.5	6.62	3.5344
2	National Highways Authority of India	8.2	6.62	2.4964
3	Infrastructure Development Finance Company Ltd (IDFC)	8.7	6.62	4.3264
4	Rural Electrification Corporation Ltd	8.12	6.62	2.25
5	India Infrastructure Finance Company Ltd	8.15	6.62	2.3409
6	National Hydro Electric Power Corporation Ltd (NHPC)	8.43	6.62	3.2761
7	State Bank of India	9.25	6.62	6.9169
		59.35	46.34	25.1411
	Standard Deviation (σ)	1		
	$\sigma = \sqrt{((\sum (R - R^-)^2)/n)}$	1.0019		
	B	3.28321E-30		
	Sharp Ratio	13.01		
	Treynor Ratio	45.2219		
	Jensen Ratio	966.67		

Source: Secondary Data

Table 3 explains the calculation of Risk and return relationship with selected NCDs which are holding maturity period of 5 years. The Standard Deviation calculated for the selected NCDs is 1. A beta value that is greater than 1.0 indicates that the security's price is theoretically more volatile than the market. As per the calculation Beta value represents 3.28 for NCDs having maturity of 5 years. This indicates that adding the stock to a portfolio will increase the portfolio's risk, but may also increase its expected return. Sharpe ratio is positive with the value of 13.01 specifies the investment return is greater than the risk-free rate. The higher the Sharpe Ratio, the greater risk-adjusted-performance. Treynor ratio result was 45.221 which represents higher Treynor ratio is better at compensating the investor for risk-taking as compared to the other fund. Jensen's measure is one of the ways to determine if a portfolio is earning the proper return for its level of risk. In other words, a positive value for Jensen's alpha means a fund manager has "beat the market" with their stock-picking skills. As per table 2 Jensen Ratio resulted with 966.97 which reflects the greater return on the investment.

Table 4: Calculation of Beta, Sharpe Ratio, Treynor Ratio and Jensen Ratio on NCDs with maturity period of 7 years

S.No.	Company Name	Bond Rate	Risk Free Bond Rate	Difference 2
1	Power Finance Corporation Ltd	8.43	6.62	3.2761
2	National Highways Authority of India	8.2	6.62	2.4964
3	Indian Railway Finance Corporation Ltd	8.19	6.62	2.4649
5	Rural Electrification Corporation Ltd	8.01	6.62	1.9321
6	India Infrastructure Finance Company Ltd	8.01	6.62	1.9321
7	Jawaharlal Nehru Port Trust	6.82	6.62	0.04
8	National Housing Bank	6.82	6.62	0.04
9	National Hydro Electric Power Corporation Ltd (NHPC)	8.18	6.62	2.4336
10	Non-Technical Popular Categories Ltd (NTPC)	8.66	6.62	4.1616
11	Indian Renewable Energy Development Agency Ltd	8.16	6.62	2.3716
12	State Bank of India	9.5	6.62	8.2944
		88.98	72.82	29.4428
	Standard Deviation (σ)	0.8		
	$\sigma = \sqrt{(\sum (R - R^-)^2/n)}$	0.8055		
	B	3.14416E-30		
	Sharp Ratio	-2.045		
	Treynor Ratio	65.7889		
	Jensen Ratio	943.34		

Source: Secondary Data

Table 4 focuses on the calculation of Risk and return relationship with selected NCDs which are holding maturity period of 7 years. According to the above table, The Standard Deviation calculated for the selected NCDs is 0.8. A beta value that is greater than 1.0 indicates that the security's price is theoretically more volatile than the market. As per the calculation Beta value represents 3.14 for NCDs having maturity of 7 years. This indicates that adding the stock to a portfolio will increase the portfolio's risk, but may also increase its expected return. Sharpe ratio is negative with the value of -2.045 specifies the investment return is bad when comparing to the risk-free rate. Treynor ratio result was 65.221 which represents higher Treynor ratio is better at compensating the investor for risk-taking as compared to the other fund. Jensen Ratio resulted with positive value of 943.34 which represents the proper return for its level of risk.

Table 5: Calculation of Beta, Sharpe Ratio, Treynor Ratio and Jensen Ratio on NCDs with maturity period of 10 years

S.No.	Company Name	Bond Rate	Risk Free Bond Rate	Difference 2
1	Power Finance Corporation Ltd	8.20	6.62	2.4964
2	National Highways Authority of India	8.30	6.62	2.8224
3	Indian Railway Finance Corporation Ltd	8.10	6.62	2.1904
5	Rural Electrification Corporation Ltd	7.38	6.62	0.5776
6	India Infrastructure Finance Company Ltd	7.34	6.62	0.5184
8	National Housing Bank	8.26	6.62	2.6896
9	National Hydro Electric Power Corporation Ltd (NHPC)	8.54	6.62	3.6864
10	Non-Technical Popular Categories Ltd (NTPC)	8.73	6.62	4.4521
11	Indian Renewable Energy Development Agency Ltd	8.80	6.62	4.7524
12	State Bank of India	9.45	6.62	8.0089
		83.1	66.2	32.1946
	Standard Deviation (σ)	0.97		
	$\sigma = \sqrt{((\sum (R - \bar{R})^2)/n)}$	0.9710		
	B	2.82232E-30		
	Sharp Ratio	14.8525		
	Treynor Ratio	59.6248		
	Jensen Ratio	950.7		

Source: Secondary Data

Table 5 showed the calculation of Risk and return relationship with selected NCDs which are holding maturity period of 10 years. According to the above table, The Standard Deviation calculated for the selected NCDs is 0.97. A beta value that is greater than 1.0 indicates that the security's price is theoretically more volatile than the market. As per the calculation Beta value represents 2.82 for NCDs having maturity of 10 years. This indicates that adding the stock to a portfolio will increase the portfolio's risk, but may also increase its expected return. Sharpe ratio is positive with the value of 14.852 specifies the investment return is greater than the risk-free rate. The higher the Sharpe Ratio, the greater risk-adjusted-performance. Treynor ratio result was 59.624 which represents higher Treynor ratio is better at compensating the investor for risk-taking as compared to the other fund. Jensen Ratio resulted with positive value of 950.7 which represents the proper return for its level of risk.

Table 6: Calculation of Beta, Sharpe Ratio, Treynor Ratio and Jensen Ratio on NCDs with maturity period of more than 10 years and upto 15 years

S.No.	Company Name	Bond Rate	Risk Free Bond Rate	Difference 2
1	Power Finance Corporation Ltd	8.75	6.62	4.5369
2	National Highways Authority of India	8.27	6.62	2.7225
3	Indian Railway Finance Corporation Ltd	7.34	6.62	0.5184
5	Rural Electrification Corporation Ltd	8.62	6.62	4
6	India Infrastructure Finance Company Ltd	8.38	6.62	3.0976
8	National Housing Bank	8.63	6.62	4.0401
9	NHPC Ltd	8.79	6.62	4.7089
10	NTPC Ltd	8.48	6.62	3.4596
11	Indian Renewable Energy Development Agency Ltd	8.55	6.62	3.7249
		75.81	59.58	30.8089
	Standard Deviation (σ)	0.97		
	$\sigma = \sqrt{(\sum (R - R_{\bar{}})^2 / n)}$	0.9754		
	B	-2.0479		
	Sharp Ratio	1.7252		
	Treynor Ratio	5.3049		
	Jensen's Ratio	956.65		

Source: Secondary Data

Table 6 explained the calculation of Risk and return relationship with selected NCDs which are holding maturity period of more than 10 and upto 15 years. According to the above table, The Standard Deviation calculated for the selected NCDs is 0.97. A beta value that is less than 1.0 means that the security is theoretically less volatile than the market. Including this stock in a portfolio makes it less risky than the same portfolio without the stock. As per the calculation Beta value represents -2.0479 for NCDs having maturity of 10 years to 15 years. This indicates that adding the stock to a portfolio will decrease the portfolio's risk, but may also decrease its expected return. Whereas, Sharpe ratio is positive with the value of 1.7252 specifies the investment return is greater than the risk-free rate. The higher the Sharpe Ratio, the greater risk-adjusted-performance. Treynor ratio result was 5.3049 which represents higher Treynor ratio is better at compensating the investor for risk-taking as compared to the other fund. Jensen Ratio resulted with positive value of 956.65 which represents the proper return for its level of risk.

Table 7: Calculation of Beta, Sharpe Ratio, Treynor Ratio and Jensen Ratio on NCDs with maturity period of more than 15 years

S.No.	Company Name	Bond Rate	Risk Free Bond Rate	Difference 2
1	Power Finance Corporation Ltd	8.92	6.62	5.29
2	National Highways Authority of India	8.5	6.62	3.5344
3	Indian Railway Finance Corporation Ltd	8.65	6.62	4.1209
5	Rural Electrification Corporation Ltd	8.37	6.62	3.0625
6	India Infrastructure Finance Company Ltd	8.75	6.62	4.5369
8	National Housing Bank	8.76	6.62	4.5796
9	National Hydro Electric Power Corporation Ltd (NHPC)	8.67	6.62	4.2025
10	Non-Technical Popular Categories Ltd (NTPC)	8.91	6.62	5.2441
11	Indian Renewable Energy Development Agency Ltd	8.8	6.62	4.7524
		78.33	59.58	39.3233
	Standard Deviation (σ)	1.07		
	$\sigma = \sqrt{((\sum (R - \bar{R})^2)/n)}$	1.0789		
	B	6.0495		
	Sharp Ratio	22.6477		
	Treynor Ratio	68.4657		
	Jensen Ratio	959.17		

Source: Secondary Data

Table 7 explained the calculation of Risk and return relationship with selected NCDs which are holding maturity period of more than 15 years. According to the above table, The Standard Deviation calculated for the selected NCDs is 1.07. A beta value that is greater than 1.0 indicates that the security's price is theoretically more volatile than the market. As per the calculation Beta value represents 6.049 for NCDs having maturity of 10 years to 15 years. This indicates that adding the stock to a portfolio will increase the portfolio's risk, but may also increase its expected return. Sharpe ratio is positive with the value of 22.6477 specifies the investment return is greater than the risk-free rate. The higher the Sharpe Ratio, the greater risk-adjusted-performance. Treynor ratio result was 68.4657 which represents higher Treynor ratio is better at compensating the investor for risk-taking as compared to the other fund. Jensen Ratio resulted with positive value of 959.17 which represents the proper return for its level of risk.

FINDINGS

1. Simple percentage analysis was used to draw the conclusion that all of the different forms of NCDs offered investors higher returns. Therefore, NCDs are strongly advised for obtaining the guaranteed returns and additional returns.
2. The beta calculation revealed that, with the exception of one segment, all maturity periods have positive beta values. A stock with a beta value greater than one is said to be more volatile than the entire index.
3. The Sharpe index calculates the portfolio's risk premium in relation to the overall level of risk. The discrepancy between the portfolio's average return and the risk-free return is the risk premium. The risk is shown by the portfolio's standard deviation. The assets with the best risk-adjusted rate of return are given the highest values by the index. The analysis's good and positive findings have an impact on NCDs' favourable returns.
4. The Treynor ratio assesses the additional returns that a fund produces above and beyond risk-free returns. As a result, it contrasts the portfolio risk premium with the portfolio's systematic risk, as shown by its beta. The Treynor ratio, which illustrates the link between risk and return, yields positive and encouraging results overall.
5. The Jensen ratio calculates the percentage of the portfolio's rate of return that may be attributed to the manager's capacity for above-average returns after taking account of market risk. The better the risk-adjusted returns, the higher the ratio. According to the study, all of the different securities with varying maturities have created excessive returns, which suggests that the NCDs have greater and more reliable returns in every way.

SUGGESTIONS

- a. **To the Investors:** Regarding the current study, investors can invest in fixed income securities to earn greater and guaranteed returns, even though the product carries risk and with subject to business risk.
- b. **To the Regulatory Authorities:** It is suggested that in order to keep track on the performance and risk level of fixed income instruments, the regulatory authorities should establish rules and regulations for NCDs.
- c. **To the Issuers:** Businesses issuing bonds to raise more than Rs. 1000 crores must assess their financial status in terms of risk and associated returns.
- d. **To Society:** In general, fixed income securities protect the investment; as a result, they can be thought of as guaranteed investment returns. Using NCDs to its economic advantage is advantageous for society.

CONCLUSION

The analysis of the relationship between risk and return aids the investor in selecting the securities of his choosing. This type of research offers data on how different market equities have performed in terms of risk and return. This essay places particular emphasis on how changes in the market affect the prices of scrip. Although it is challenging to spot patterns in price movements, efforts have been made utilising Treynor ratio, Sharpe ratio, and Beta analysis. Corporate investments are quite risky, and it is expensive to investigate all financial products across all spectrums. By offering ratings based on different ratios and key performance indicators, credit rating agencies assist corporate companies and investors in the area of investment. Investors are capable of making wise financial choices and taking reasonable risks. Foreign investment can be attracted by corporations. Ratings thereby increase market stability, efficiency, and decrease information asymmetry.

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