
Rating Criteria For Micro, Small And Medium Enterprises- A Study

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Abstract:

The present article deals with micro, small and medium enterprises and their credit rating. MSMEs are credited with generating high rates of employment growth and account for a major share of industrial production and exports. Credit risk assessment in this segment requires a specific approach, because the factors affecting the creditworthiness are somewhat different compared to the large corporate entities. Hence, to further support the growth for this sector and help the investors to determine the relative creditworthiness of entities belonging to this segment, a need for separate rating product was felt. Credit ratings assess the financial viability of the MSMEs and its capability to honor business obligations. Rating highlights the overall health of the enterprise and benchmarks its performance within the industry for an effective peer review.

Keywords: Credit risk, Credit rating, Micro, Small and Medium Enterprises.

Introduction

The Micro, Small and Medium Enterprises sector plays an important role in any developing economy. Micro, Small and Medium Enterprises faces the many opportunities and challenges in India. Many opportunities have opened up for the small scale sector to enhance productivity and look for new markets in other countries. Therefore, there is a need to create awareness amongst Micro, Small and Medium Enterprises about the strengths and weaknesses of their operations. As a step in their direction, a need was felt for introduction a rating scheme for the Micro, Small and Medium Enterprises. It is expected that rating would encourage MSMEs sector in improving its contribution by way of increasing their productivity. Credit rating scheme would enhance their acceptability in the market and make access to credit at cheaper cost. Ministry Of Micro,

Small and Medium Enterprises has been launched a “Performance & Credit Rating Scheme” for MSMEs in consultation with various stakeholders i.e. Small Industries Association and various rating agencies- CRISIL, ICRA and ONICRA etc.

Credit ratings assess the financial viability of the MSMEs and its capability to honor business obligations. Rating highlights the overall health of the enterprise and benchmarks its performance within the industry for an effective peer review. Objective of a rating is to measure risk and establish credit worthiness of a MSMEs unit. They suggest “A lower rating is better than no rating” (**Case Study by SMERA, 2011**).

The rapid growth of the SME sector creates exciting lending opportunities for banks and financial institutions. A credit rating takes a significant chunk of the perceived uncertainty out of their lending decisions, and reduces time and transaction costs in the system. The Indian rating industry has established its credibility in providing in-depth and unbiased analysis; ratings are therefore highly respected by lenders

Credit Rating Agencies for MSMEs:

There are so many rating agencies in India like ICRA, SMERA, ONICRA and CRISIL. These agencies are doing a good job related to rating of Micro, Small and Medium Enterprises in India.

SMERA (Small and Medium Enterprises Rating Agency of India Ltd.)

A. Only rating agency dedicated to the SME segment offering qualitative services at competitive prices.

B. Joint initiative of SIDBI, Dun & Bradstreet and 11 leading banks operating in SME segment.

C. Launched on the 5th September 2005 by the Hon. Finance Minister, Shri P. Chidambaram.

D. Completed over 18000 ratings till date (en.wikipedia.org/wiki/SMERatingAgencyofIndia).

ICRA (Investment Information and Credit Rating Agency)

A. ICRA Limited is an independent and professional investment information and credit rating agency.

B. ICRA Limited, was established in 1991, and was originally named Investment

Information and Credit Rating Agency of India (IICRA).

C. It was a joint venture between Moody's and various Indian commercial banks.

D. Rates distinctly, separately on

- Performance capability (viz., scale "1" to "5")
- Financial strength (viz., scale "A" to "C")

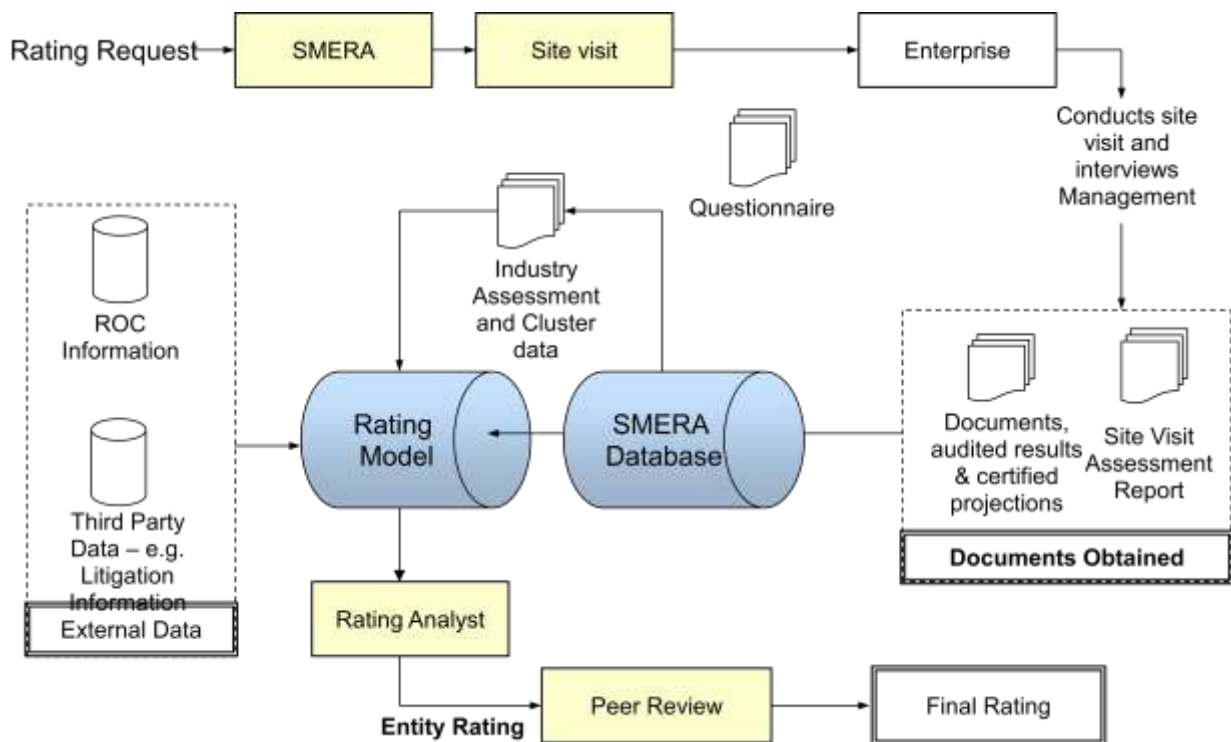
CRISIL (Credit Rating Information Services of India Limited)

A. CRISIL is a global analytical company providing ratings, research and risk & policy advisory services. It was established in 1987.

B. CRISIL's majority shareholders are Standard & Poor's, a division of the McGraw- Hill Companies and provider of financial market intelligence.

C. CRISIL rating has rated over 61000 entities in India (<http://smallb.in/%20fund-your-business%20credit-rating%20msme-rating%20rating-agencies-india>).

Credit Rating procedure given by SMERA (Small and Medium Enterprises Rating Agency of India Ltd.)



(Source: www.smera.in)

The rating process will be undertaken in the following manner:

Step 1. Request for rating from MSMEs units.

Step 2. Collection of information from the MSMEs units.

Step 3. Onsite meeting with MSMEs management.

Step 4. Analysis of information obtained from the MSMEs units.

Step 5. Assign credit rating and communicate it to the MSMEs units (National Institute of Securities Market, 2009).

Rating Scale of MSMEs on Performance and Credit Parameters under the Performance & Credit Rating Scheme for MSMEs.

Rates separately on the basis of performance capability (viz., scale “1” to “5”) and financial strength (viz., scale “A” to “C”).

Rating Scale	Performance and Credit Parameters
SE 1A	Highest Performance Capability & High Financial Strength
SE 1B	Highest Performance Capability & Moderate Financial Strength
SE 1C	Highest Performance Capability & Low Financial Strength
SE 2A	High Performance Capability & High Financial Strength
SE 2B	High Performance Capability & Moderate Financial Strength
SE 2C	High Performance Capability & Low Financial Strength
SE 3A	Moderate Performance Capability & High Financial Strength

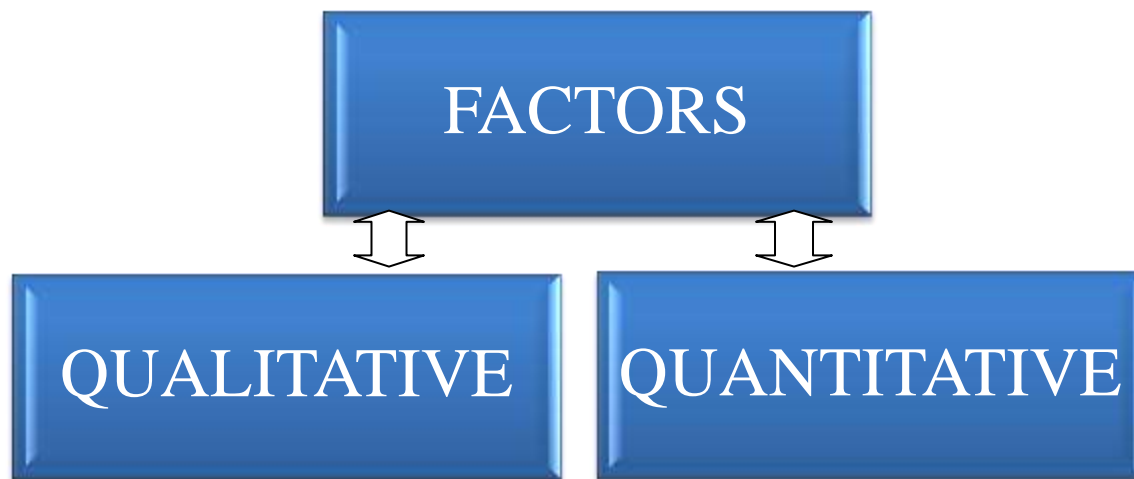
SE 3B	Moderate Performance Capability & Moderate Financial Strength
SE 3C	Moderate Performance Capability & Low Financial Strength
SE 4A	Weak Performance Capability & High Financial Strength
SE 4B	Weak Performance Capability & Moderate Financial Strength
SE 4C	Weak Performance Capability & Low Financial Strength
SE 5A	Poor Performance Capability & High Financial Strength
SE 5B	Poor Performance Capability & Moderate Financial Strength
SE 5C	Poor Performance Capability & Low Financial Strength

(Source: www.icra.com).

Rating Criteria for Micro, Small and Medium Enterprises in India:

The MSMEs are assessed on the basis of two broad factors i.e. quantitative factors

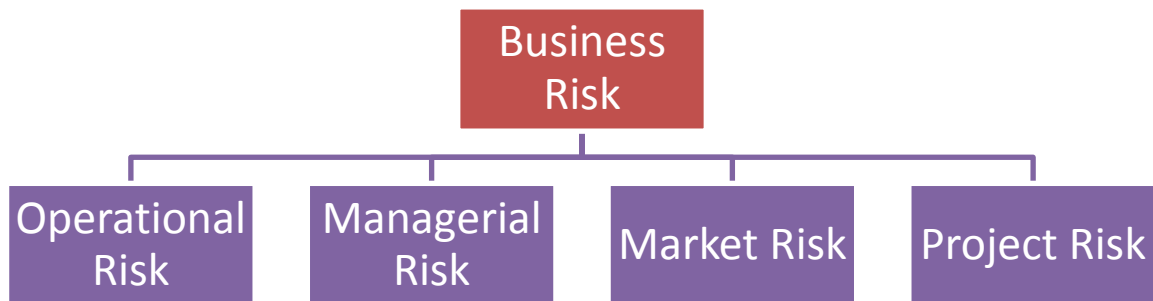
based on statistical model such as ratio analysis and qualitative factors based on site visit. Such factors include industry characteristics, management quality, and relationship with employees etc.



1. Qualitative Factor Study or Analysis:

Qualitative factor mainly includes business risk study. Business risk is

the risk to loss of income because of the cyclical fluctuation, changes in customer's choice and technological innovations etc.



A. Operational Risk Factors:

(www.careratings.com).

1. Infrastructure of company
2. Labour Availability
3. Raw material supply
4. Geographical factor etc.

B. Market Risk Factors:

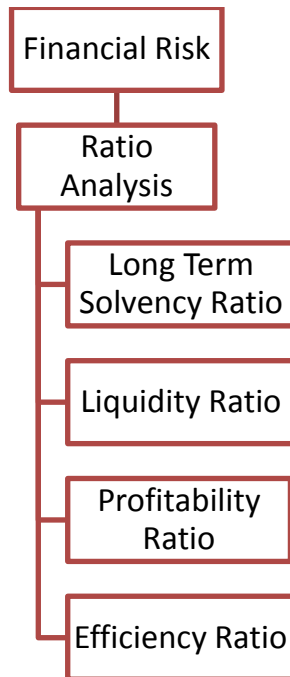
1. Market competition
2. Position of company in market
3. Business cycle etc.

C. Project Risk Factors:

1. Size of project
2. Funding of project
3. Contingency
4. Technology etc.

2. Quantitative Factors Study or Analysis:

It consists of financial risk analysis. Financial risk analysis includes some ratio analysis of the company and these are mentioned below;



2. Debtor Turnover Ratio
3. Creditor Turnover Ratio
4. Working Capital Turnover Ratio etc (Source: www.onicra.com).

The rating outcome is ultimately an assessment of the above factors and their linkages to arrive at the overall assessment of credit strength and weaknesses by taking into account industry's cyclicity. While the methodology encompasses comprehensive technical, commercial, economic, and management analysis, credit rating is an overall assessment of all aspects of the issuer.

The rating agencies shall peruse the documents received and in case of any short fall, rectification thereof within a period of 15 days. If the particulars are not received within the period mentioned the agency shall the reminder giving further 15 days time for submission.

From the date of receipt of all information from the applicant unit, the rating agency shall complete the exercise of evaluation and award of rating within one month thereof.

A. Long Term Solvency Ratio

Analysis:

1. Debt to Equity Ratio
2. Interest Coverage Ratio
3. Debt to Total Fund Ratio
4. Net Worth Ratio etc.

B. Liquidity Ratio Analysis:

1. Current Ratio
2. Liquid Ratio etc.

C. Profitability Ratio Analysis:

1. Net Profit Ratio
2. Return on Equity
3. Return on Investment etc.

D. Activity or Efficiency Ratio

Analysis:

1. Stock Turnover Ratio

Recommendations:

1. Timeliness of Ratings
2. Measures to prevent shopping for ratings
3. Proper education given to public on usage of ratings
4. Use of proper code of conduct for CRAs

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