



ICRA

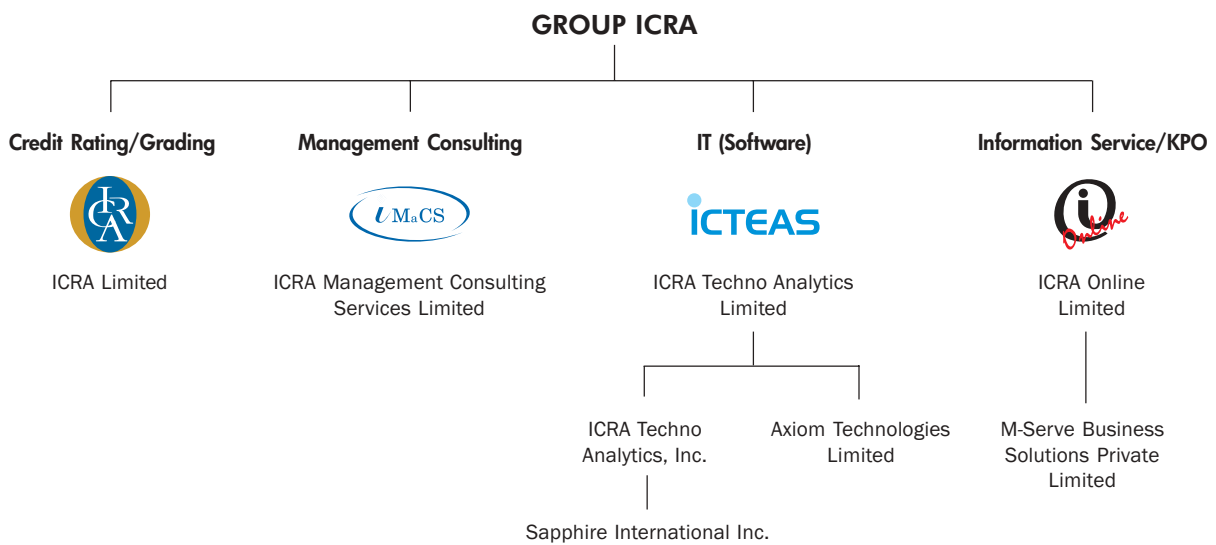


Rating of Micro, Small and Medium Enterprises



About ICRA

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional Investment Information and Credit Rating Agency. The international Credit Rating Agency **Moody's Investors Service** is ICRA's largest shareholder. Today, ICRA and its subsidiaries together form the ICRA Group of Companies (**Group ICRA**). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.



Background

Micro, small and medium enterprises (MSMEs) comprise a pivotal sector of the Indian economy, employing the largest workforce among all sectors other than agriculture, promoting entrepreneurship, and contributing significantly to economic growth. However, even as its importance is widely acknowledged, the MSME sector has historically found itself deprived of timely and adequate institutional finance. The primary reason for this has been the lack of credible information on the functioning and performance of the MSME sector. One way to bridge this “information gap” and thereby improve the sector’s access to institutional finance is to encourage MSMEs obtain Credit Ratings from credible Credit Rating Agencies.

ICRA is one of the leading Credit Rating Agencies in India, with a sound understanding of the MSME sector and its “real world” dynamics. It offers its MSME Rating Services in two ways: as **ICRA-NSIC Performance and Credit Rating for SSIs**, and as **ICRA SME Ratings**.

The **ICRA-NSIC Performance and Credit Rating** Scheme is one that ICRA has launched along with National Small Industries Corporation Limited (NSIC) for Small Scale Industrial Units (SSIs) in India on a special Rating Scale, using criteria tailored for SSIs.

Under this scheme, the Rating Fee payable by an eligible SSI is subsidised once by NSIC, with the result that the SSI concerned pays a concessional fee to ICRA.

Under the **ICRA SME Rating** service, on the other hand, ICRA rates Small and Medium Enterprises (SMEs), including Micro Enterprises, on a separate SME Rating Scale that is linear, which makes it easily comparable with the internal rating scales of most banks. The **ICRA SME Rating** service is so designed as to cover all MSMEs, including those that are eligible for the ICRA-NSIC Performance and Credit Rating Scheme.

An MSME Rating (on either scale) assigned by ICRA is a symbolic indicator of ICRA’s current opinion on the relative capability of the MSME concerned to timely service its debts and obligations. A Credit Rating of an MSME together with the Rating Rationale seeks to provide the lender with an unbiased view of the creditworthiness of the rated entity. In the absence of any other independently verifiable information, the importance of the role of Credit Rating in supplementing the lender’s loan appraisal process can hardly be overemphasised. For the MSME too, the benefits of Rating could be significant.

The Benefits

For lenders, an ICRA MSME Rating would:

- Provide an objective, independent and reliable opinion on credit quality
- Serve as an additional input in the credit decision making process
- Assist in risk pricing and capital allocation
- Facilitate portfolio management and monitoring

For the rated MSME, an ICRA MSME Rating may help to:

- Improve the comfort level with prospective/existing lenders
- Negotiate better terms on the basis of the credit quality reflected by the Rating
- Reduce the time involved in obtaining loan approvals
- Project a better image to prospective/existing trade partners
- Carry out self-evaluation and take timely and corrective measures for improvement

¹ For a complete list of ICRA’s Rating and Grading products please refer ICRA’s website www.icra.in.

ICRA-NSIC Performance and Credit Rating for SSIs

ICRA Limited along with National Small Industries Corporation Limited (NSIC) has launched a Performance and Credit Rating Scheme for SSIs in India on a special Rating Scale, using criteria tailored for the small-scale sector. The Rating service is aimed at enabling SSIs improve their access to institutional credit, increase their competitiveness, and raise their market standing. The Rating methodology covers credit and performance factors, including parameters that measure operating, financial, business and management risks.

The fee for this Rating service is currently subsidised by the Government of India, making it a unique opportunity for small enterprises to get themselves rated. The subsidy is available to an eligible SSI only once. The total subsidy obtainable is 75% of the Rating fee payable to ICRA, subject to the following turnover-linked ceilings: Rs. 25,000 for entities with annual turnover of up to Rs. 50 lakh; Rs. 30,000 for entities with annual turnover of between Rs. 50 lakh and Rs. 2 crore; and Rs. 40,000 for entities with annual turnover exceeding Rs. 2 crore.

ICRA-NSIC Performance and Credit Rating Scale

		Performance Capability				
		Highest	High	Moderate	Weak	Poor
Financial Strength	High	SE 1A	SE 2A	SE 3A	SE 4A	SE 5A
	Moderate	SE 1B	SE 2B	SE 3B	SE 4B	SE 5B
	Low	SE 1C	SE 2C	SE 3C	SE 4C	SE 5C

Example: A company with **High Performance Capability** and **Moderate Financial Strength** is rated **SE 2B**, while one with **Moderate Performance Capability** and **Low Financial Strength** is rated **SE 3C**.

ICRA SME Rating

ICRA has developed a separate SME Rating Scale that covers all MSMEs, including those that are eligible for the ICRA-NSIC Performance and Credit Rating Scheme. While Rating SMEs (including Micro Enterprises), ICRA evaluates factors such as the candidate SME's management, ownership, organisation structure, key human resources, business environment, relationships with trade partners, financial strength, operating

efficiency and capabilities, and other non-financial parameters that may have a bearing on its creditworthiness. Among other things, an ICRA SME Rating seeks to bridge the "information gap" that a lender may face while evaluating a credit proposal made by an SME. The ICRA SME Rating Scale is linear, which makes it easily comparable with the internal rating scales of most banks.

ICRA SME Rating Scale

ICRA SME 1	The highest-credit-quality rating assigned by ICRA to an SME.
ICRA SME 2	The high-credit-quality rating assigned by ICRA to an SME.
ICRA SME 3	The adequate-credit-quality rating assigned by ICRA to an SME.
ICRA SME 4	The moderate-credit-quality rating assigned by ICRA to an SME.
ICRA SME 5	The inadequate-credit-quality rating assigned by ICRA to an SME.
ICRA SME 6	The risk-prone-credit-quality rating assigned by ICRA to an SME.
ICRA SME 7	The poor-credit-quality rating assigned by ICRA to an SME.
ICRA SME 8	The lowest-credit-quality rating assigned by ICRA to an SME.

Note: For the Rating categories **ICRA SME 2** through to **ICRA SME 7** the sign of + (plus) or - (minus) may be appended to the Rating symbols to indicate their relative position within the Rating categories concerned. Thus, the Rating of **ICRA SME 2+** is one notch higher than **ICRA SME 2**, while **ICRA SME 2-** is one notch lower than **ICRA SME 2**.



Why ICRA?

ICRA is eminently suited to rate MSMEs in India because of a host of factors including the following:

- Cumulative Experience and Research Capability:** As an early entrant in the Credit Rating business, ICRA is one of the most experienced Credit Rating Agencies in the country today. Established in 1991, ICRA has dedicated teams for Monetary, Fiscal, Industry and Sector research, and a panel of Advisors to enhance its in-house capabilities. Further, ICRA has a Technical Services Agreement with its largest shareholder Moody's Investors Service², which, among other things, provides for the International Rating Agency reinforcing ICRA's in-house research capabilities and offering it access to Moody's global research base.
- Rating Expertise:** ICRA's acknowledged expertise in the Rating domain is spread deep and wide over an extensive range. It includes, besides MSME Rating, the services of Credit Rating; Structured Finance Rating; Bank Loan/Line of Credit Rating (Basel II); Corporate Governance Rating; Stakeholder Value and Governance Rating; Project Finance Rating; Issuer Rating; Mutual Fund Rating; Rating of Claims Paying Ability of Insurance Companies; and Rating of Parallel Marketers of Liquefied Petroleum Gas and Superior Kerosene Oil. This wide spectrum of Rating services is in turn complemented by ICRA's long track record, the sheer number of Rating assignments it has executed over the years, and the distribution of its Ratings across various Rating levels.
- Grading Expertise:** As in Ratings, in the Grading domain too, ICRA's range of services is almost equally wide, covering Grading of: Initial Public Offers; Microfinance Institutions; Construction Entities; Real Estate Developers and Projects; Healthcare Entities; and Maritime Training Institutions.
- Dedicated Team for MSME Rating:** ICRA has a separate team dedicated exclusively to carrying out MSME Ratings. This team consists of professional analysts with an in-depth understanding of the "real world" business dynamics in which MSMEs operate. What this translates into is that the analysis (which culminates in the Rating) also factors in aspects that may not be purely financial but nonetheless have a material bearing on an MSME's creditworthiness.
- Specialisation Across Sectors:** Over the years, ICRA has carried out Rating assignments across a wide spectrum of industries, including, automotives, pharmaceuticals, cement and building materials, textiles, hotels, metals and mining, media, retail public finance, and infrastructure and utilities (power, oil & gas, and transportation). ICRA's extensive and in-depth sector specialisation ensures not only Rating consistency but also quicker turnaround. ICRA's highly-specialised analyst teams are spread across eight offices, servicing clients across the country and thereby ensuring comprehensive geographic coverage. ICRA's Ratings are used extensively by all kinds of investors and lenders to assess risks associated with credit or investment decisions. Besides, ICRA's Ratings and research are also used as key inputs for economic research and for strategic purposes by players in the Corporate, Public Finance, Financial, Infrastructure and Utilities, and Structured Finance sectors, among others.
- Wider Acceptability among Banks and FIs:** ICRA is one of the few Rating Agencies whose Bank Loan/Line of Credit Ratings are recognised by the Reserve Bank of India (RBI) in the context of risk allocation against exposures. Given its background and the number of Rating assignments it has executed over the years, ICRA enjoys very high credibility among banks, financial institutions (FIs), investors, the capital markets community and other users of its Rating services.
- Association with Moody's:** ICRA draws upon the long and extensive experience of Moody's Investors Service to constantly fine-tune its own Rating methodologies and criteria. The International Rating Agency's wide experience across geographies, issuer segments and categories also helps ICRA benchmark its default statistics and Rating transition rates.

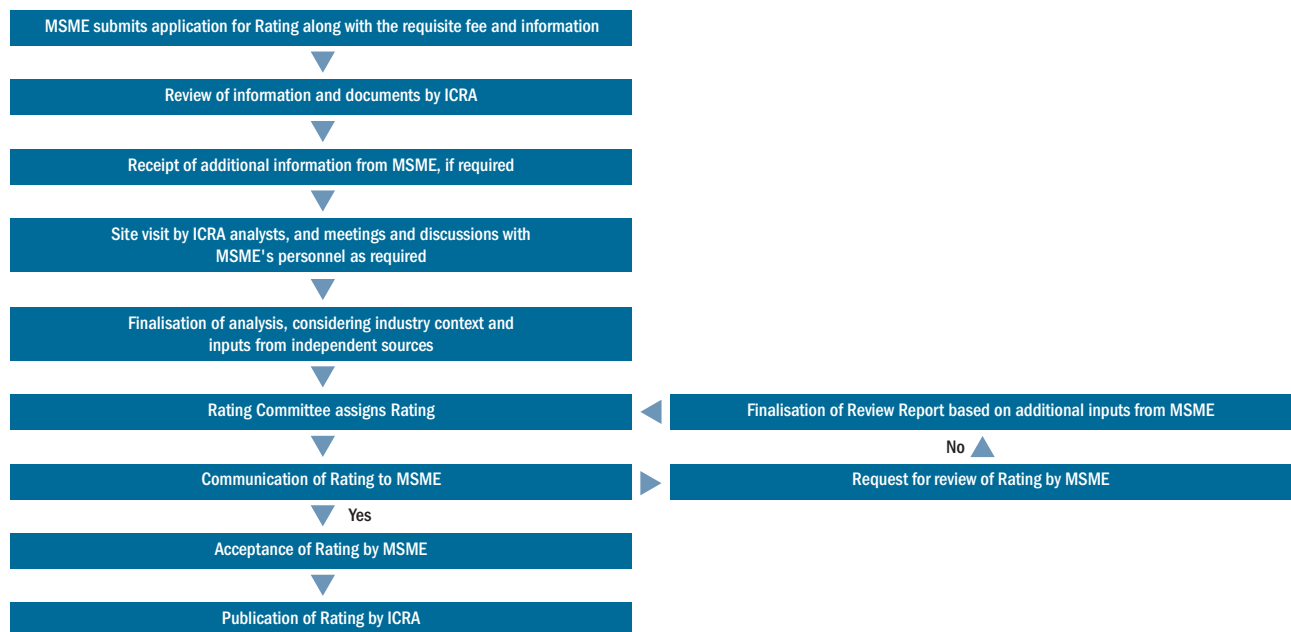
² through its Group company Moody's Investment Company India Private Limited

The Rating Process

The Rating process starts with the receipt of application in the prescribed format along with the requisite fee and relevant information and documents from the MSME client. After review of the information and documents received, ICRA, if required, sends a communication to the client seeking additional information, documents and/or clarifications. This is followed by site inspection, management interview and interaction with the key personnel of the MSME concerned. After this, a detailed analysis is carried out by the analyst(s) (having the expertise and skills necessary to evaluate the MSME's business), factoring in financial and non-financial aspects impacting the MSME's future cash flow generation capabilities. ICRA also draws on secondary sources of information, including its own research, while working on the Rating assignment. After completing the analysis, a Rating Report is prepared, which is then presented to the ICRA Rating Committee.

A presentation on the MSME client's business and management is also made by the Rating Team. The Rating Committee is the final authority for assigning Ratings. The assigned Rating together with the key issues is communicated to the MSME client for acceptance. Non-accepted Ratings are not disclosed and complete confidentiality is maintained on them unless such disclosure is required under any law/regulations.

If the MSME client does not find the Rating acceptable, it has a right to appeal once for review. Such a review is taken up only if the MSME provides certain fresh inputs. During the review, the client's response is presented to the ICRA Rating Committee. If the Rating Committee in its collective wisdom takes the view that the fresh inputs and/or clarifications provided by the MSME do warrant a Rating revision, it will appropriately revise the Rating initially assigned.



Notes:

1. An ICRA MSME Rating is valid for 12 months from the date it is assigned or till the date of occurrence of any material development that would warrant a Rating surveillance, whichever comes earlier. On surveillance, ICRA may retain or revise (upward or downward) the rating previously assigned, depending on its assessment of the developments since the previous Rating was assigned.
2. Before an ICRA Rating expires, thereby turning invalid, ICRA recommends that the MSME concerned send a written mandate to ICRA for Rating Surveillance along with the requisite Surveillance Fee and documents. The process for Rating Surveillance is the same as that for a fresh Rating (depicted in the chart). On Surveillance, ICRA may retain or revise (upward or downward) the Rating previously assigned, depending on its assessment of the developments since the previous Rating was assigned.



The Rating Methodology

ICRA considers all relevant factors that have a bearing on the candidate MSME's future cash generation. Such factors include, among others: industry characteristics, competitive position of the MSME, operating efficiency, management quality, succession plan, relationship with employees, commitment to new projects and other associate concerns, funding policies, track record with lenders, and trade relations with suppliers and customers. A detailed analysis of the MSME's past financial statements is made to assess its performance under "real world" business dynamics. Further, the MSME's future cash generation capabilities is also assessed in the light of its past performance, the business vision of its management, the likely future business scenario in terms of viability and growth prospects, the status of projects under implementation, new and existing trade relations, commitments and debt servicing obligations.

How to Apply

The completed Rating application along with a cheque/demand draft for the requisite Rating fee is to be handed over to the ICRA representative or sent across to any of the ICRA offices (list on back cover). The application form can be downloaded from ICRA's website at www.icra.in or can be obtained by sending a mail to info@icraindia.com.



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