

# insight



## Credit ratings will benefit the SME sector

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Over the years, the Indian financial system has come to regard credit ratings as an integral part of the framework for credit and investment decisions relating to larger enterprises. Today, as the banking sector increasingly focuses on lending and providing other financial services to the small and medium enterprises (SME) sector, ratings can play the same pivotal role as they do for larger enterprises. Ratings can make SMEs' access to financial services more efficient by providing benchmarks and improving transparency. Independent agency ratings for SMEs, based on high standards of analytical rigour, can provide greater confidence to lenders, and consequently broaden the range of financial resources available to SMEs.

### **Benefits for lenders and SMEs**

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.

SMEs can leverage their ratings for negotiating better borrowing rates and strengthening their relationships with bankers. Ratings can also facilitate faster processing of credit facilities, as rating reports provide most of the information banks need for approving loans. Further, SMEs can use ratings to enhance their credibility with other counterparties too, such as technology providers, suppliers, and customers.

#### Benefits for the sector as a whole

For the SME sector as a whole, ratings can provide an important impetus in raising standards through better financial discipline, disclosure and governance practices. Surveys among larger enterprises clearly show that managements feel ratings have provided value that goes well beyond the rating symbol. In the SME sector too, ratings can be an important feedback tool for managements. An interactive rating process helps managements gain unique perspectives on business and financial issues and on best practices, from rating experts who have in-depth sector knowledge and understanding of risk. A rating exercise can help SMEs better understand what initiatives they need to take to improve their operating and financial positions. Additionally, as the number of rated players in the SME sector increases, there will be greater transparency, as more and more information is demanded and made available.

#### SME ratings -- a viable proposition

There are certain misconceptions about SME credit ratings. Firstly, lenders and investors often assume that SMEs will only get low ratings because of their smaller size. At CRISIL, we recently had an opportunity to analyse over 5000 SMEs. Our analysis shows that there were a healthy number of companies with considerable business strengths underpinned by the leadership of first generation entrepreneurs who had built strong brands and demonstrated the ability to withstand competition, including from large global players. The combination of business and management strength indicates that there will be several players in the sector with strong credit profiles. Several large and highly successful companies today, were SMEs only a decade ago. Sun Pharma Industries, Moser Baer India, Satyam Computer Services,

Marico Industries and Maharashtra Seamless are some examples. Rating agencies are forward-looking in their analysis, and expectations are built into ratings.

Secondly there are several questions on information risk - will SMEs be able to provide quality, reliable information required for a credit rating exercise? Our interaction with SMEs has revealed that most players are willing to share reliable financial and operational information for a credit rating, as they see the tangible benefits that ratings provide. Many SMEs enjoy business relationships with large domestic and global companies, and hence already have a track record of maintaining and providing high-quality business and financial information.

The third misconception is that SMEs will find fees of rating agencies unaffordable. In its efforts to develop the credit markets, the ratings industry in India has never allowed fees to be a constraint. In fact the rating fee is by far the lowest element of the cost of raising funds, and there is no reason why this should not be so for the SME sector as well. The National Small Industries Corporation has recently launched an attractive scheme for Small Scale Industries, providing a subsidy of as much as 75% of the rating fees.

Clearly, ratings have the potential to transform the way SMEs are integrated into the financial system. But rating agencies must recognise the special initiatives they will need to take in this regard. They need to launch outreach initiatives, educating the SME sector on the benefits of ratings. Rating agencies also need to have specialised teams and analytical tools customised for the SME sector.

#### CRISIL's bouquet of services for SMEs

CRISIL has created a dedicated team for SME Ratings staffed by highly qualified and experienced personnel. This team benefits from CRISIL's rich understanding of SMEs gained over the years. CRISIL has certified over 1000 SMEs under its certification services; a CRISIL certification acts as an authentication of an SME for prospective trading partners and lenders. CRISIL has also carried out extensive research on eight SME clusters, to provide lenders authentic and reliable opinions, and thereby help credit flow to these clusters.

CRISIL Ratings' offerings in the SME sector are wide-ranging, and cover the entire gamut of services relating to the assessment of credit and performance risk. CRISIL's products address the needs of all stakeholders in the sector. CRISIL has gained rich experience and

knowledge while rating larger companies. Leveraging these strengths, CRISIL's products and services are tailor-made for the SME sector, and take into consideration the thinking, practices, needs and issues that are unique to this sector.

Other CRISIL products for the SME sector include customised studies and solutions aimed at evaluation of borrowers, dealers and vendors, and strengthening of SME credit assessment systems in Banks and Institutions. CRISIL has also tied up with NSIC to offer Performance and Credit Ratings for SSIs (Please refer to the box for a detailed write-up on the scheme).

Given its high credibility, rich experience and commitment to the SME sector, CRISIL is confident that the SME sector will benefit from its rating services the same way that the large corporates did after CRISIL introduced the concept of ratings in India.

#### NSIC-CRISIL Performance and Credit Rating

CRISIL is the pioneer of independent credit ratings in India. In association with the National Small Industries Corporation (NSIC), CRISIL is now rating Small Scale Industries (SSIs) on a special rating scale, using criteria tailored for the small-scale sector. The fees for this rating are presently subsidised by the Government, making it a unique opportunity for small enterprises to get themselves rated.

#### Rating Scale

An NSIC-CRISIL rating reflects CRISIL's opinion on the company's performance capability and financial strength. Ratings will be assigned on the following rating scale:

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

For example, a company with High Performance Capability and High Financial Strength will be rated 'SE 2A', while one with Weak Performance Capability and Low Financial Strength will be rated 'SE 4C'.

#### Benefits

When you go in for a rating from a credible agency, you improve your standing with bankers, customers, suppliers and employees. Specifically, an NSIC-CRISIL rating will bring you the following benefits:

*Credibility with banks:* A good rating from CRISIL carries weight with lenders, and can help you get faster and cheaper credit. The Indian Banks' Association (IBA) has endorsed the NSIC-CRISIL rating, and informed its member banks of the same.

*Confidence building with business partners:* Your NSIC-CRISIL Performance rating is an indicator of your performance capability and financial strength. A good rating will give comfort to your lenders, customers and suppliers.

*Self - improvement tool:* With its rating, CRISIL gives you a detailed analytical report on your company's strengths and weaknesses. The report will help you strengthen your operations and improve the working of your company. This insightful, credible and independent feedback is supported by the strongest industry and company research in India.

*Improved visibility:* With the CRISIL rating, your company will get a free listing in CRISIL's Rating Scan, a publication that is used as a reference for lending decisions by banks. We will also feature your company on CRISIL's website.

#### Why CRISIL ?

*India's leading Ratings, Financial News, Risk and Policy Advisory Company:* CRISIL leads the market in depth of analysis and sophistication of approach. A rating from CRISIL is a stamp of quality from the most renowned rating agency in India.

*Association with Standard & Poor's:* CRISIL is a subsidiary of Standard & Poor's (S&P), the world's largest rating agency. Leading corporations worldwide are rated by S&P. S&P's Credit Risk Tracker (CRT) has analysed about 10 lakh Small and Medium Enterprises (SMEs) in Europe.

*Value-driven approach:* All CRISIL businesses operate on the core values of Analytical Rigour, Independence, Integrity, Innovation, and Commitment. CRISIL's consistent adherence to these principles is recognised by users of its ratings, and has been the key factor that makes CRISIL the leading player in its field.

### Rating Process

- On receipt of the complete application form, a team of CRISIL analysts will visit you for detailed interaction
- CRISIL will then analyse the information and the inputs obtained during the interactions and arrive at your rating
- CRISIL will forward the rating report to you and NSIC
- The entire process will take about 3 - 4 weeks from the time of receipt of all necessary information and documents, including clarifications.

### Rating Fees

	Turnover (Rs. Lakh)		
	<50	50-200	>200
Rating Fees (Rs.)	40,000	45,000	60,000
Service Tax (Rs. @ 10.2%)	4,080	4,590	6,120
Total Fees (Rs.)	44,080	49,590	66,120
Subsidy from NSIC (Rs.)	25,000	30,000	40,000
Net fees for SSI (Rs.)*	19,080	19,590	26,120

\* The fees above are inclusive of all expenses CRISIL will incur in connection with the exercise. CRISIL will arrange to collect the subsidy from NSIC.

### How to Apply

- Application in the required format with the documents listed overleaf and a cheque/draft drawn in favour of "CRISIL Limited" for the amount payable (refer to "Rating Fees") to be sent to the nearest CRISIL office. The cheque/draft should be payable at any of the CRISIL office locations listed overleaf.
- Application forms can be downloaded from the website [www.crisil.com](http://www.crisil.com) or [www.nsicindia.com](http://www.nsicindia.com), or can be collected from any of the CRISIL offices listed overleaf.

### Eligibility

Any enterprise registered in India as an SSI Unit can benefit from this rating. As a proof of eligibility, we will require an SSI certificate issued by the concerned SSI registration authority.

### Cluster studies done by CRISIL

- Knitwear Sector (Tirupur)
- Auto Parts Sector - (NCR Delhi, Pune and Chennai)
- Bulk drug industry (Hyderabad, Chandigarh, Vadodara and Ankleshwar)
- Diagnostic Centres (All Metros)
- Readymade garment export sector (Delhi, Mumbai, Bangalore and Chennai)
- Gems & Jewellery
- Sports Goods industry (Jalandhar)
- Seafood processing.