Rating Criteria for Micro Small and Medium Enterprises

ONICRA is one of the leading Credit Rating and Performance Assessment 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 ONICRA-NSIC Performance and Credit Rating for SSIs, and as ONICRA MSME Ratings.

1) NSIC-ONICRA Performance and Credit Rating Matrix:

		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 5A	SE 5C

Any enterprise registered in India as a micro or small enterprise can benefit from this rating. As a proof of eligibility, ONICRA requires a registration certificate issued by the micro and small enterprise registration authority, namely, the District Industry Centre or the Directorate of Industries.

2) ONICRA MSME Ratings Matrix:

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

The units which have applied to us but do not fall under the purview of the NSIC scale, form a part of this scale. These can be further classified as Traders' cases or Full value cases.

Rating Methodology:

Rating Methodology

The SSIs are assessed on two broad factors i.e. Quantitative Factors based on statistical model & Qualitative factors based on due diligence & site visit. Such factors include industry characteristics, competitive position of the MSME, operating efficiency, management quality, succession plan, and 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 growth prospects, the status of projects under implementation, new and existing trade relations, commitments and debt servicing obligations.

Qualitative Analysis

Business Risk: Risk of business is the risk to loss of income because of the changes in sector, cyclical fluctuations, changes in customer choices and technological innovations. In addition to this, financial losses caused by the loss of market share at the end of the increase in competitiveness or decrease on the barriers to enter the market are also listed under this risk category. Business Risk is categorized into four broad headings- Operational Risk, Managerial Risk, Market & Macroeconomic Risk and Project Risk.

Operational Risk

A study of the operational risk covers the micro environment in which the entity operates. A SME faces a dynamic world in which it has little control.

- Infrastructure
- Geography
- Labor availability and relations
- Raw material supply
- Substitutes and potential new products
- Customer and supplier relationship
- Technology
- Capacity
- Integration and diversification
- Company profile
- Product profile
- Sensitivity to Forex rate fluctuation
- Impact of global downturn
- Parentage

Managerial Risk

This studies the management – its ability and willingness to support the business in times of need, expansion and downturn. Apart from the constitution and the bandwidth, the managerial risk studies the risk-return profile of the management, its inter-dependencies etc.

- Promoters strength, background and experience
- Attitude of the promoter/management to risk taking and containment
- Risk Management Practices
- Intra group Transactions
- Board of Directors
- Succession plan and strength
- Management Bandwidth
- Corporate Governance

Market & Macroeconomic Risk

- Competitor Analysis
- Potential Threats
- Market Position
- Pricing Power
- Industry Outlook
- Sensitivity to Government Regulations
- Cyclicality of Business

- Market Trend
- Criticality of Business
- Strength and Depth of Distribution Network
- Regulatory Risk
- Intensity of Competition

Project Risk

- Project Size
- Implementation Risk
- Funding
- Technology
- Track Record
- Contingency
- Competitive Environment
- Demand Outlook

Quantitative Analysis

The basis of the analysis is to evaluate the rated entity's ability to create cash, the structure of the income gained, and effective resource utilization. Rated Entity's' cash flow and profitability ratios are the most important indicators of how they will finance their activities and debt refund. Quantitative analysis method consists of financial risk analysis. In financial risk analysis, some ratio analyses are made to measure some basic subjects mentioned below.

Financial structure: they are the ratios to be referred to measure the sufficiency of firm's equity, capital structure and to what kind of current asset or fixed assets used the funds that are created as equity.

- **Financial Position**
  - net worth / total assets
  - fixed assets / equity capital

- **Indebtedness Position**
  - debt to equity ratio
  - long term liabilities / total liabilities
  - long term liabilities / (continuous capital: long term liabilities + equity capital)
  - fixed assets / continuous capital
  - banks loans (including interests) / total assets
  - DSCR/ interest coverage ratio

Liquidity Ratios

- Quick Ratio
- Current Ratio
- cash ratio

Growth rate

- average sale growth rate during the last three years (Percentage)
- capital increment during the last three years (Percentage)
- total profit growth rate (Percentage)

Profitability Ratios

- Profit Margin (%)
- Return on Assets (%)
- Return on Equity

Working capital management

Efficiency/ Activity Ratios

- inventory turnover: (cost of sales (current year) / (last year inventory + current year inventory)/2)
- receivables turnover: (net sales/average trade receivables)
- working capital turnover: (net sales/current assets)
- net working capital turnover: (net sales/(current assets-current liabilities)
- tangible assets turnover: (net sales / net tangible assets)
- equity turnover: (net sales / equity capital)
- asset turnover: (net sales / total assets)

Accounting policies and disclosures

Contingent Liabilities/Off balance sheet items

End use of borrowed funds