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Rating Criteria for Micro, Small & Medium Enterprises (MSMEs) - Under PCR & Non-PCR Scheme

A. Rating Criteria for Micro & Small Enterprises (MSEs) under PCR scheme

Brickwork undertakes rating of MSME under PCR (Performance Credit Rating) scheme of National Small Industries Corporation, where in the concerned MSE receives subsidy from NSIC. BWR also rates other MSME and they have been dealt in separate criteria and scale and titled Non PCR ratings.

The Micro and Small Scale Enterprises (MSEs) play an important role in the development of our country. The MSEs bring in dynamism, resourcefulness and risk taking abilities to sustain the process of economic growth. The MSEs are given an increasing policy attention in recent years in view of their contributions, such as: greater utilisation of local raw materials, employment generation, rural development, mobilisation of savings, linkages with larger industries, balanced regional development and provision for self-employment.

The MSEs have been defined in the Micro, Small & Medium Enterprises Development (MSMED) Act, 2006, as follows:

Manufacturing Sector: A micro enterprise is an enterprise where investment in plant & machinery does not exceed Rs.25 lakhs and a small enterprise is more than Rs.25 lakhs but does not exceed Rs.5 crores.

Services Sector: A micro enterprise is an enterprise where investment in equipment does not exceed Rs.10 lakhs and a small enterprise is more than Rs.10 lakhs but does not exceed Rs.2 crores.

Performance & Credit Rating Scheme: National Small Industries Corporation (NSIC) is the nodal agency for implementing the Performance and Credit Rating Scheme for the Small-Scale Industries Sector. The objective of the Scheme is to create awareness amongst micro & small enterprises about the strengths and weaknesses of their operations and also their credit worthiness. The rating methodology shall cover a combination of credit & performance factors including parameters measuring operational, financial, business and management risks. In order to facilitate the ratings process, NSIC empanels the SEBI Registered Credit Rating Agencies. Brickwork Ratings (BWR) is one of the empanelled credit rating agency to carry out the MSE Rating under PCR Scheme.

MSE Rating Scale

BWR has adopted a rating scale for MSE's as prescribed by NSIC and the same may be referred in the table here below for NSIC Mandates.

NSIC – BWR Performance and Credit Rating Scale for Micro and Small Enterprises

Rating Symbol	Definition
BWR MSE 1	Highest credit worthiness in relation to other MSEs
BWR MSE 2	High credit worthiness in relation to other MSEs
BWR MSE 3	Good credit worthiness in relation to other MSEs
BWR MSE 4	Above Average credit worthiness in relation to other MSEs
BWR MSE 5	Average credit worthiness in relation to other MSEs
BWR MSE 6	Below Average credit worthiness in relation to other MSEs
BWR MSE 7	Weak credit worthiness in relation to other MSEs
BWR MSE 8	Poor credit worthiness in relation to other MSEs

Financial Strength
Highest
High
Good
Above Average
Average
Below Average
Weak
Poor

Operating Performance
Highest
High
Average
Weak
Poor

Credit Rating Scale Illustration: (under PCR scheme)

XYZ Limited: BWR MSE 1

Financial Strength: Highest

Operating Performance: High

The above ratings signify its creditworthiness in relation to other MSEs. In all there are 8 rating scales, MSE 1 is the highest and MSE 8 being the lowest. The rating also indicates the performance capability in 5-point scale and financial strength in 8-point scale.

Rating considerations

BWR's rating considerations takes into account the following aspects:

- Brickwork MSME rating criteria includes five main categories: Financial Conditions, Characteristic and Perspective of the product, Operation Risk and Competitive Strength, Management Measure and Conditions of Industry of evaluated MSMEs.
- The industry in which a company operates, together with the company's competitive position within that industry, are key factors in assessing business risk.

- High dependence on only one major production facility or market, or a limited number of customers - characteristics common to micro, small and midsize enterprises (MSMEs) - could also affect credit quality, even when this dependence underpins the company's high degree of success. BWR considers this too in their rating analysis, where appropriate.
- Poor financial flexibility is usually a negative rating factor for MSMEs because of their limited capacity to withstand unexpected setbacks, and their limited access to external cash debt or equity to cover near-term vulnerabilities or temporary cash shortfalls.
- Larger firms generally have substantially more staying power and often benefit from the extended support of key stakeholders in times of stress who provide a platform for launch of new products and continue to thrive.
- Fast growth may be pursued at the expense of profitability, and good projects may be subject to poor execution

B. Rating Criteria for Micro, Small & Medium Enterprises (MSMEs) Under Non-PCR scheme

Micro, Small and Medium Enterprises are the backbone of economic development in India. As incubators for talent, innovation and entrepreneurial spirit, they are essential for the country's development. The importance of MSMEs in the manufacturing sector is mainly due to the quantum of units that fall in this category, forming 90% of the total industrial units in the country.

The major bottleneck faced by MSMEs is the unavailability of sufficient and timely funds to finance their growth plans. It is reported that most MSEs in India meet as high as 93% of their financing needs by internal and informal sources. Delay in settlement of dues to MSEs by their customers adversely affects their recycling of funds and business operations. Access to credit for MSME sector is often difficult as banks and financial institutions are wary of their track record. The financing gap for MSMEs in the developing country has a few well-accepted causes. These include information asymmetries, higher risks, sizeable transaction costs and a lack of adequate collateral. Poor quality of projects seeking funding and the inability of MSMEs to make the best possible use of available resources of funding further aggravate the problems. Considering the importance of MSMEs to the economy, it is important to address various issues affecting MSME performance in the current economic climate. A credit rating mechanism which is a trusted third party opinion on the capabilities and creditworthiness of the MSMEs can help MSMEs to access finance. BWR is committed to help the MSME sector by offering credit ratings.

BWR's analytical approach for MSMEs is comprehensive and covers Business, Management, and Financial Risk. The Operating performance of MSMEs is analysed through assessment of Business and Management risk.

Business risk

In order to assess the business risks, BWR holds discussions with the promoters of the MSME unit to understand their business plans and growth strategies. BWR assesses the sustainability of a business and an entity's long-term viability by studying the track record of the business, the profiles of customers, the relationships with customers and suppliers and level of infrastructure and technology in the business. Typically, MSMEs are a part of the value chain of larger industries and are usually not in direct contact with the end-users. Assessing the entity's relationship with its key customers and suppliers is important. Interactions with management and bankers and feedback from various stakeholders viz., suppliers, customers etc. may provide crucial insights into business risk.

Management risk

Management evaluation, which typically involves assessing promoter competence, is critical to the rating exercise. MSMEs primarily depend on the entrepreneurship and resourcefulness of their promoters. BWR looks at the past performance of an entity - and group companies, if any - when assessing the competence of its promoters, their track record and ability to successfully manage business cycles. The organisational structure, systems and processes, availability of second tier of management and professional workforce are analysed to examine the long-term sustainability of the business. Most MSMEs are managed by first-generation entrepreneurs so their continuity is crucial to the business. The ability to develop supply chain, integrate with customers and manage banking and labour relationships also provide critical inputs to the management evaluation process.

Financial strength

MSMEs are typically set up as proprietorships, partnerships or private limited companies. The accounting quality, disclosure, and transparency in financial management are some of factors used as necessary. The size of the entity in terms of sales and net worth, profitability, efficiency of capital, working capital management, credit protection metrics such as interest coverage, debt service coverage and cash accrual to debt ratios are evaluated. Standard financial ratios as necessary are also analysed. The financial flexibility of the entity is based on the Net Worth of promoter/s and relationships with banks.

Overall rating/ creditworthiness

The overall creditworthiness of an MSME is arrived at after taking into consideration its operating performance and financial strength, which will ensure sustainability of business and ability of the entity to meet financial obligations in a timely manner. Brickwork Ratings for MSMEs are valid for one year only from the assigned date. A rating review may be undertaken based on fresh / additional information provided by the MSME and the rating assigned afresh. Brickwork has adopted a separate rating scale for MSMEs and the same may be referred in MSME Rating Scale.

Rating Scale

BWR adopts the following Rating Scale:

Non-PCR BWR MSME Credit Rating Scale

Rating Symbol	Definition
BWR SME 1	Highest credit worthiness in relation to other SMEs
BWR SME 2	High credit worthiness in relation to other SMEs
BWR SME 3	Good credit worthiness in relation to other SMEs
BWR SME 4	Above Average credit worthiness in relation to other SMEs
BWR SME 5	Average credit worthiness in relation to other SMEs
BWR SME 6	Below Average credit worthiness in relation to other SMEs
BWR SME 7	Weak credit worthiness in relation to other SMEs
BWR SME 8	Poor credit worthiness in relation to other SMEs

Disclaimer:

It must be clearly understood that a Rating opinion is based on various factors/aspects which includes application of certain Rating criteria. The particular criteria applied depends on a number of factors, inter alia, sector/Industry, historical performance, cyclical trends, prevailing economic condition, group support etc. Rating opinions factor many assumptions and the application of any particular criteria or a set of criteria may be full or partial depending upon peculiarity of each case. Application of any Rating criteria should not therefore be considered as rendering finality or completeness to a Rating assessment. A reference to criteria needs to be perceived in broad terms, only as an aid to a rating decision.