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Rating Criteria for Services Sector

The Services sector is the key driver of India's economic growth. Not only is it the dominant sector in India's GDP, but it has also attracted significant foreign investment flows, contributed significantly to exports as well as provided large-scale employment. They function as process improvement facilitators / service providers / requirement facilitators. India's services sector covers a wide variety of activities such as Retail, Hospitality, Logistics, Storage and communication, Audit firms, Information Technology, BPO, KPO, Real estate, Business services, Community, social and personal services, Construction services, Healthcare, Tourism etc. Services sector growth is governed by both domestic and global factors

BWR framework for the Services entities covers assessment of **Business Risk, Industry Risk, Financial Risk and Management Risk**, applying the standard criteria defined in our Rating Criteria documents on [Manufacturing Companies](#) and [Trading Companies](#) and [General Criteria](#). In addition, depending on the type of services industry, sector specific factors are also taken into consideration.

Business risk focuses on the ability of the entity to sustain its business and have consistent cash flow over the long run. Apart from the standard parameters, additional parameters include Diversity of the clients, Market position & Revenue composition, Type of service provided, Quality standards & Processes adopted.

Diversity of the clients: The factors looked into are whether the clients of the entities are well distributed in terms of different Industries, whether majority of the customers are individuals / diversified groups, whether any established / reputed / government entities are present in the client base and whether stable cash flows are expected by the entity over the long run and the revenue realisations by the entities are steady. If the majority of the revenue is from a particular industry than the performance of that particular industry is also taken into consideration.

Market Position & Revenue composition: BWR analyses market share in the industry for the particular service, the range of services offered by the entity, scale of operations, economies of scale and profitability margins of the entity. Flow of orders, repeat customers and adaptability to change the revenue mix and type i.e. franchise based, managed, leased and other revenue sharing mechanisms that may add stable cash flows which improve the earnings quality of the entities are other factors.

Kind of services provided: The kind of services offered by the entities and the demand, competition, uniqueness of the service offered is also taken into consideration. Performance indicators inherent to a particular service sector that explain the operational efficiency of the business (For example: For a Hotel chain, the performance indicators may be: Occupancy levels, Revenue per available room) are analysed.

Quality standards & processes adopted: The quality standards, certifications, standard operating processes and resources/infrastructure in place for the entity to deliver quality services consistently have a strong bearing on the business risk profile of the company.

Industry Risk: BWR's assessment of industry risk generally consists of the following factors: Competition, Industry performance of the target entities, technological changes/disruptions, regulatory changes, threat from the competitors/substitutes. Depending on the business model of the rated entity, the economic and various external factors impacting the particular service sector is also taken into consideration. Generally, the services entities act as service providers for other core industries, so the performance of the core industries will be a critical factor for the stable cash flow / sustainability of business of these entities. Various tax benefits / government regulations are also taken into consideration, where available.

Financial Risk: Financial risks emphasize the ability of the entity to service its debt obligations, efficiency with which it is managing its operations and the relative size of the entity in terms of Tangible Net worth, that acts as a cushion for the borrowings of the entity. Please also see [General Criteria](#), Approach to Financial ratios.

Management Risk: BWR follows the standard criteria for assessing the management risk of the service based entities detailed in [General Criteria](#).

Conclusion: BWR's rating methodology for the services sector involves analysis of Business risk, Industry Risk, Management risk and Financial risk profiles and analysis of related financial ratios.

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.