

Credit Rating to Benefit Small and Medium Enterprises

Dr. B. K. Mukhopadhyah*

Credit rating is catching on. In the Small Scale Industries (SSI) sector, more than 1000 companies have already got themselves rated since the scheme was introduced by the National Small Industries Corporation (NSIC) one year ago. It will spread in a big way in the coming years inasmuch as the SSI sector has started realizing the benefits accruing from getting rated. NSIC acts as the nodal agency to enable the SSI firms to get rated by leading agencies like, CRISIL, ICRA, CARE, SMERA, Fitch, Dun & Bradstreet. NSIC has developed a standard format of 12 categories, with 1 being the best and 11 being the worst – keeping in view that each credit rating agency has its own terminologies. Therefore, based on the rating given by any of these 6-7 agencies, it is converted and fitted into one of NSIC's 12 types. In today's global environment, it is actually a good credit rating that could give multiple benefits to the SSIs like credit at concessional rate, better acceptability in the exports markets, etc. In fact, there are 19 lakh registered SSI units and if the unregistered units are also taken into account, then the total number of SSI units in the country would cross even one crore mark. NSIC has also been giving a subsidy of 75 percent and the unit desirous of getting rated could do so by paying only 25 percent of total charge - ranging between Rs. 25000 to Rs. 50000.

Dun & Bradstreet, in association with SMERA, has also been empowering SMEs through ratings. There is a need to enhance the visibility in the global

arena and for that, comprehensive and reliable source of information is of utmost necessity. Such agencies do undertake similar exercise which, in turn, serves as valuable source not only to SSI or SME units but also to bankers, ministries, institutions as well as consultants. ICRA, for example, possesses a rich data base, research support, product and service innovation and experienced management backed by demonstrated track record. They do possess experienced and strong management professionals from leading banks, finance companies and other rating agencies and has alliances with rating agencies in Kuwait and Bangladesh. ICRA provides mutual fund related information services and outsourcing. ICRA provides various rating and grading products viz. corporate governance ratings, project finance ratings, issuer ratings and grading of maritime training institutes, healthcare institutions and real estate developers and projects.

The rating exercise is very crucial in matters like taking up of big projects. In such cases a number of services are required to be rendered – approvals relating to designs, drawings and specifications for all of the sub-systems, monitoring of works progress, assurance to quality, approvals related to maintenance and operations, system safety plan, conduct of various tests and trials, as well as other duties and responsibilities. For the purpose, the competencies are to be vetted – be it an individual firm, consortia, or joint

ventures and international level-playing position is to be looked into viz., whether having the necessary expertise / relevant experience / capability. Adequate information / data are, thus, required to be inquired before the green signal is given. Risks are to be appropriately assessed before entrusting the job to the really eligible. For example: the credit risk refers to the conventional counter party risk – the risk the counter party may fail to fulfill his obligation as per the terms of the contract – thereby putting the other party to a financial loss. Again, the legal risk refers to the risk associated with unenforceability of contracts due to defective documentation or due to various laws or any other lacunae. Side by side, the operational risks cannot simply be neglected – the risk arising out of inadequate system and procedures, internal control, computer failures or frauds by employees. Movement in market variables leads to market risks. In the financial markets interest rate is virtually the single most important variable. Currency risk, commodity price risk, equity price risk, etc. call for definite attention. These aspects, thus, call for adequate insights. Possibility or probability of loss is the thing which the very term "risk" wants to specifically and categorically indicate.

Multi-disciplinary projects' implementation essentially calls for scanning of appropriate skills and expertise. For example, selection and employment based on technical and financial

* Member of Faculty, Indian Institute of Bank Management (IIBM), Guwahati

parameters in a big city or metro project are done in accordance with World Bank guidelines. Great ideas are essential for improving the work place - where people, performance and profit matter the most – hence look before the leap!

In fact, the Indian financial system has now come to regard credit ratings as an integral part of the framework for credit and investment decisions regarding the enterprises –big or small. The clear emphasis is there on the SSI as well as the SME sector. The call is to augment the flow of institutional finance to these sectors – doubling the flow to SME sector within next five years. Not only the public sector banks but also the leading private sector banks like ICICI and other foreign banks like

HSBC are also making a big foray into this sector. Ratings make SMEs' access to financial services more efficient by providing the benchmarks as well as improving transparency. It is very clear, thus, that the independent agency ratings for SMEs based on high standards of assessment - business risk, financial risk , operational risk , sales risk , industry risk , borrower risk , conduct of the account - in depth and unbiased approach, can provide greater confidence to lenders and hence broaden the range of financial resources available .

Ratings can provide the impetus in the matter of raising standards through better financial discipline, disclosure and governance practices .On the part of the rating agencies it would be better

if the outreach initiatives – educating the SMEs sector on the benefits of ratings – are taken up. Specialized team backed by analytical tools like assessment of the credit and performance risk , needs of all stake holders taking into consideration the thinking, practices, needs and issues, customized studies and solutions meant for borrowers, dealers, vendors' evaluation, etc. could render good services meant for growth of such sectors as well . Authentic and reliable options could help better confidence building, self-improvement tools, visibility as well as credit flow to the deserving and act an impetus in raising standards through better financial discipline, disclosure and governance practices!

CREDIT RATING FOR SMEs

Need of a Performance and Credit Rating Mechanism for SSIs was highlighted in Union Budget'04-05. A scheme for SSIs has been formulated in consultation with Indian Banks' Association (IBA) and rating agencies. National Small Industries Corporation (NSIC) has been appointed as the nodal agency for implementation of this scheme through empanelled agencies.

Benefits of Performance and Credit Rating

- An independent and trusted third party opinion on capabilities and credit-worthiness of SSIs
- Availability of credit at attractive interest
- Recognition in global trade
- Prompter sanctions of credit from banks and financial institutions
- Subsidized rating fee structure for SSIs
- Facilitate vendors/buyers in capability and capacity assessment of SSIs
- Enable SSIs to ascertain the strengths and weaknesses of their existing operations and take corrective measures.

Benefits to Banks and Financial Institutions

Availability of an independent evaluation of the strength and weaknesses of an SSI unit seeking credit and thereby enabling banks and financial institutions manage their credit risk

Salient Features

- A combination of credit and performance factors including operations, finance, business and management
- Uniform rating scale for all empanelled agencies
- SSIs have the liberty to choose among the empanelled rating agencies.
- Turn over based fee structure
- Partial reimbursement of rating fee through NSIC

Empaneled Agencies

- Dun & Bradstreet(D&B)
- ICRA
- FITCH
- ONICRA
- CARE
- CRISIL

Performance and Credit Rating Fee :

Decided by the respective rating agency

Reimbursement of Performance and Rating Fee

Turn Over of SSI	Reimbursement of	Fee through NSIC
Upto Rs 50 Lakh	75% of the fee or Rs 25000/-	(Whichever is less)
Above Rs 50 to 200 lakh	75% of the fee or Rs 30000/-	(Whichever is less)
More than Rs 200 lakh	5% of the fee or Rs 40000/-	(Whichever is less)

(Source: www.nsicindis.com)