



Webinar organized by EEPC India

August 7, 2020 at 4:00 PM

Key Factors for MSMEs Grading/ Rating

August 2020

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**ICRA
ANALYTICS**

A Group ICRA Company

Agenda



1	About ICRA Analytics Limited
2	A Quick Look at MSMEs
3	Funding Challenges & How Grading / Rating Helps
4	Key Factors for Grading / Rating
5	Grading Process
6	Paradigm Shift Ahead
7	Summarizing the discussion

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About ICRA Analytics Limited

ICRA Analytics - Who we are

About Us

ICRA Analytics Ltd (IAL) is a wholly-owned subsidiary of ICRA Ltd

Moody's Investor Service is ICRA's largest shareholder

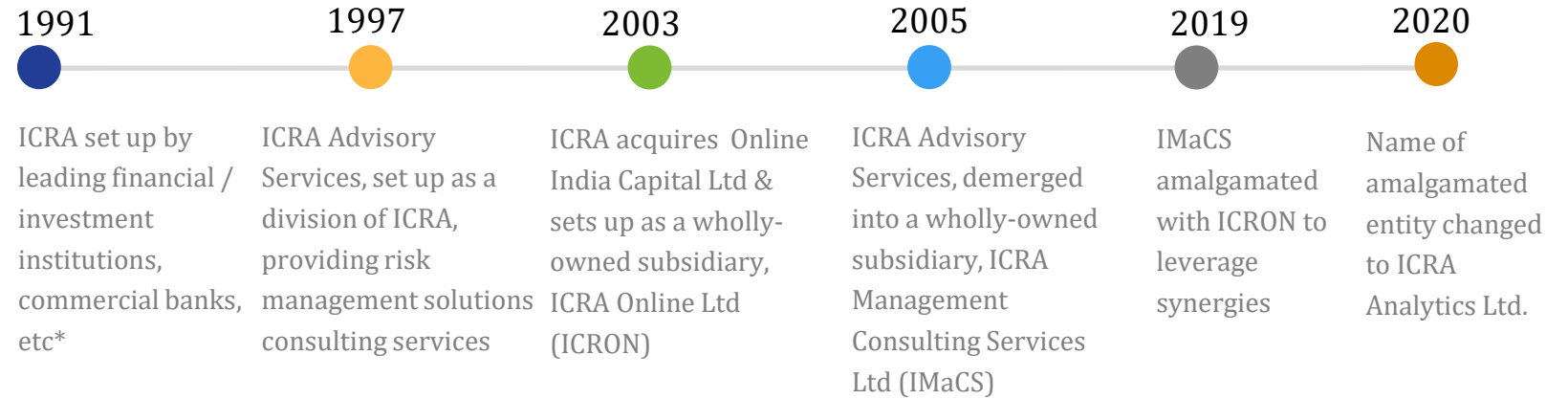
IAL offers risk management solutions, market data, consulting and knowledge services

600+ professionals in India with ISO 9001:2015 and ISO27001:2013 certifications

Completed 10,000+ assignments over the last 20+ years

* ICRA Ltd, is currently a public listed company with shares listed on NSE and BSE and Moody's Investor Service as its largest shareholder

Our Corporate Journey



Our Offerings

Risk Management

Internal Rating Software for banks, Credit Risk Modeling, Industry Risk Scoring, etc.

Consulting

Consulting in Energy & Renewables and Development Sector

Market Data

Daily pricing of active ISINs through Security Level Valuation, Indices, Rating Tracker, etc.

Knowledge Services

Automated data management, GAAP & IFRS accounting support, Research, etc.

ICRA Analytics Limited (formerly, ICRA Online Ltd.), is the amalgamated entity of ICRA Online Limited and ICRA Management Consulting Services Limited, both wholly-owned subsidiaries of ICRA Limited.

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A Quick Look at MSMEs

MSMEs at a glance

Change in definition*



Micro Enterprise

Investment[^]: Not more than Rs. 1 crore

Annual Turnover: Not more than Rs. 5 crore



Small Enterprise

Investment[^]: Not more than Rs. 10 crore

Annual Turnover: Not more than Rs. 50 crore



Medium Enterprise

Investment[^]: Not more than Rs. 50 crore

Annual Turnover: Not more than Rs. 250 crore

Market size¹

Large Market size: Total MSME: 63.4m (6.8m registered and 56.6m unregistered) of which 137k rated between 2005 and 2017

High geographical concentration: 10 states (UP, WB, TN, MH, KR, BH, AP, GJ, RJ & MP) comprise 74% of MSME

High credit exposure: Credit exposure to MSME and individuals ~ 25% (Rs. 17.75 lakh crore)

Role in economy



Creates **employment** in large scale



Reduces regional imbalance through industrialization of rural India



Ensures equitable **income distribution**



Accounts for around **29% of the country's GDP²**



MSME related product account for **nearly half the exports** from India²



Supports large industries by serving as ancillary units

*With effect from July 1, 2020; [^]Investment in Plant and Machinery or Equipment; 1 - Source: CII, TransUnion CIBIL, SIDBI, MSME annual report, RBI; 2 - Source: Press Information Bureau

Recent government announcements to provide fillip



Rs. 3 lakh crore collateral-free automatic loans

Aimed at supporting MSMEs and is expected to benefit 45 lakh units. Banks would lend up to 20% of the outstanding credit. Loans would be fully guaranteed



Subordinate debt provision of Rs. 20,000 crore

Aimed at providing equity support to promoters of stressed units with up to 15% of their stake or upto Rs 75 lakh per promoter.



Equity infusion of Rs. 50,000 crore through Fund of Funds

Government to put in Rs. 10,000 crore fund of fund corpus and leverage it. This would be equity infusion with exit option via IPO.



Initiative towards automation in lending

Trade Receivables Discounting System (TReDS): Receivables drawn against buyers are financed

Source: Press Information Bureau , Union Budget

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Funding Challenges and
How Grading / Rating
Helps

Funding challenges

Despite rising importance in the economy, MSMEs are grappled with numerous challenges

Timely sanction of loan

Lack of timely disbursement and adequate finance constrains growth

01

Interest rate

High interest rates is the top concerns of MSMEs

02

03

Fund for daily operation

Lack of adequate working capital limits for raw material purchases and for scaling up operations

04

Collateral and security margin

MSMEs have time and again raised concerns over high amount of collaterals for working capital and other loans

How grading / rating can help



Easier funding

Access to credit gets easier,
and at better rates



Less loan approval time

Time for obtaining loan
approvals can come down



Better credit terms

Better terms can be negotiated
basis the credit quality with a
good grading / rating



Attract stakeholders

Sourcing orders from big
players and attracting
investors could get easier



Gain credibility

Helps in building credibility,
thereby opening new
business avenues



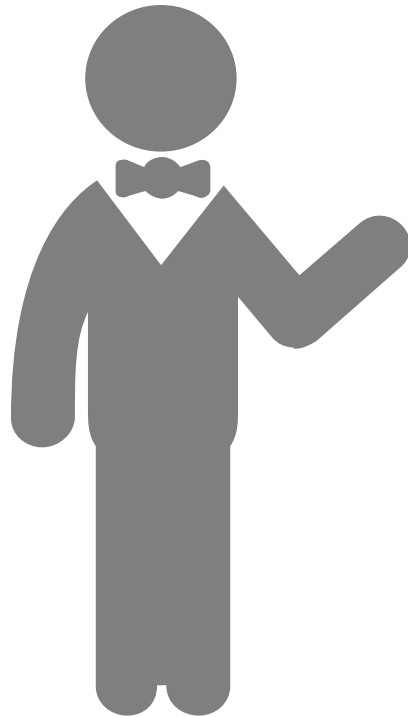
Self improvement tool

Serves as a self-betterment
tool to take timely and
corrective measures for
improvements

4

Key Factors for Grading /
Rating

Parameters considered for grading /rating



a.

Financial parameters

1. Growth in revenue and profitability
2. Debt-Equity mix
3. Working capital management and cash position

b.

Non-financial parameters

1. Industry: Performing industry analysis
2. Business: Assessing competitive position, business capability, etc.
3. Management: Assessing management track record, experience, qualification, etc.

a

Financial Parameters

Financial parameters

1. Growth in revenue and profitability



Revenue

Steady growth in revenue is desirable



Profit

Healthy operating and net profits suggests sustainable growth



ROCE

Gives idea about the company's profitability and capital efficiency



Revenue visibility

Pending orders and short-term/ long-term contracts give revenue visibility

2. Debt - Equity mix



Debt to equity ratio

High degree of leverage is undesirable



DSCR and interest coverage

The higher the ratio, shows greater comfort in repayment of principal and interest



Debt to net worth

Compares debt level to net worth of the company and determines risk level



Net cash accrual to debt

Shows the cash position for debt repayments

Financial parameters *(contd.)*

3. Working capital management and cash position



Operational cycle

Calculating operational cycle of receivables, payables and inventory is essential to understand working capital requirement



Sanctioned limits

Assessing if limits are enough to meet operational needs. Utilization pattern is also evaluated



Current ratio

Understanding the liquidity position of the firm to meet short term obligations



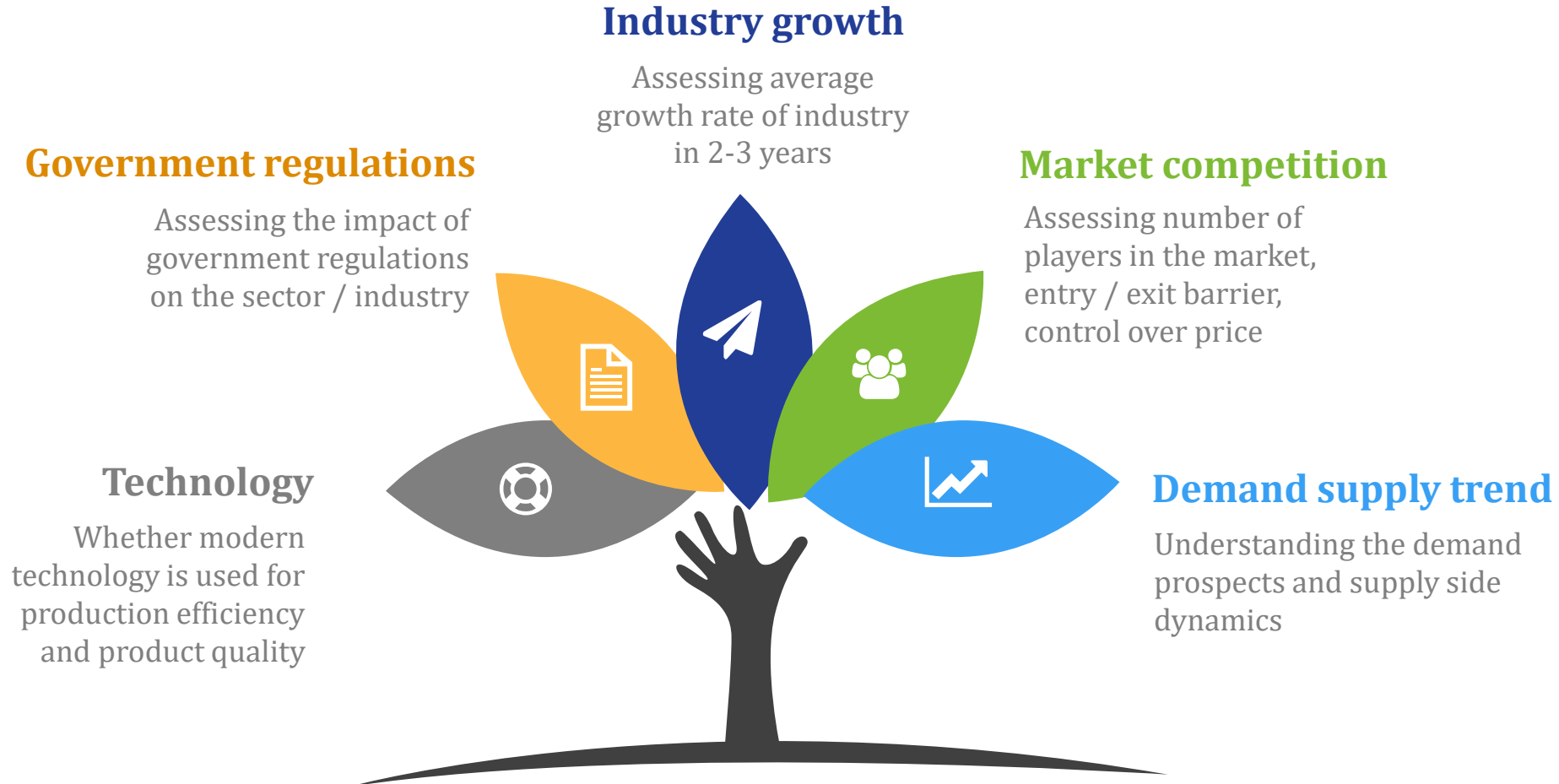
Operating cash flow

Key metric to assess whether the core business is able to generate cash

b

Non-financial Parameters
(Industry + Business + Management)

Industry analysis



b

Non-financial Parameters
(Industry + Business + Management)

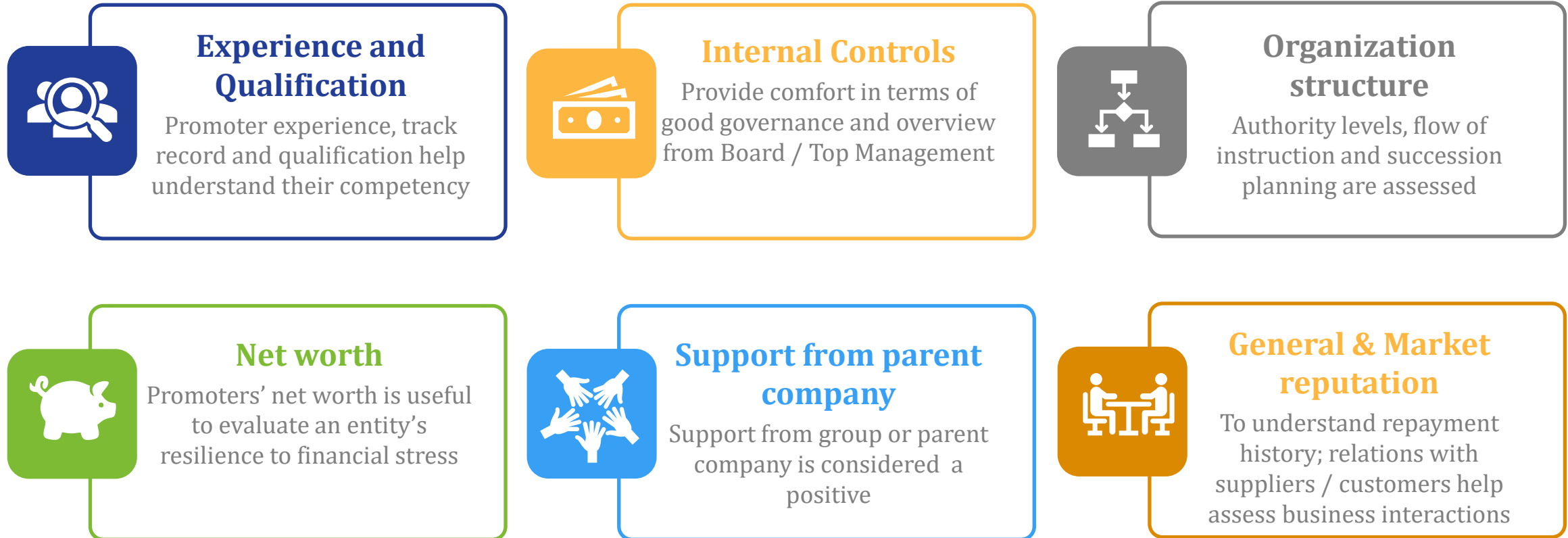
Business model competitiveness



b

Non-financial Parameters
(Industry + Business + Management)

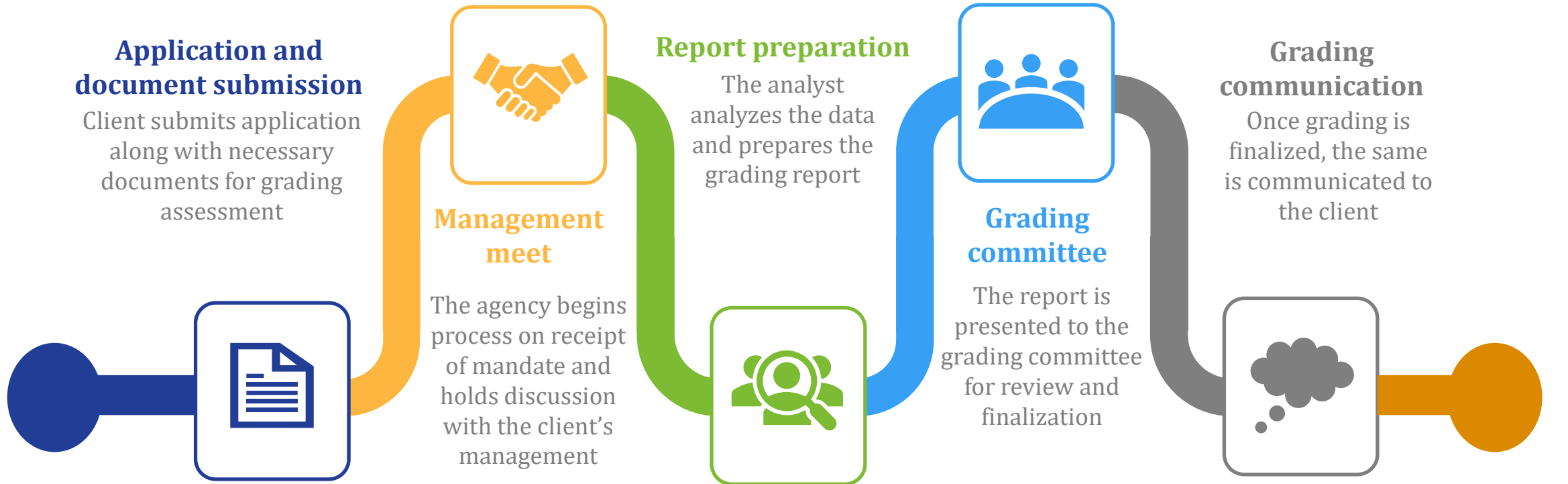
Management experience, track record and more



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Grading Process

Grading process



←..... The entire grading process takes around 3-4 weeks→

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Paradigm Shift Ahead

Alternate data: A key differentiator

Compliance determines the character of a business, its policies, legal obligations, statutory requirement, etc.

Major differentiator while assessing an MSME from its peers

Even with limited financial history, statutory compliance is must

Maintaining documents and preparing MIS help in controlling process

Compliance adherence, documentation and MIS come in handy during grading/rating process as well as in loan application

Merchandise Exports from India Scheme (MEIS) aims to boost exports of Indian products by giving duty credit scrip to the exporter

**Return
filing as
per statute**

**GST
payment
and filing**

**PF and
TDS
deposit**

**Advance
income tax
payment**

**Filing of
financial
statement**

**Auditing and
other
compliances**

Key takeaways

Borrow within limits and have a target Debt Equity mix. Balance is the key

File returns on time and as per regulations. GST, IT, MCA...

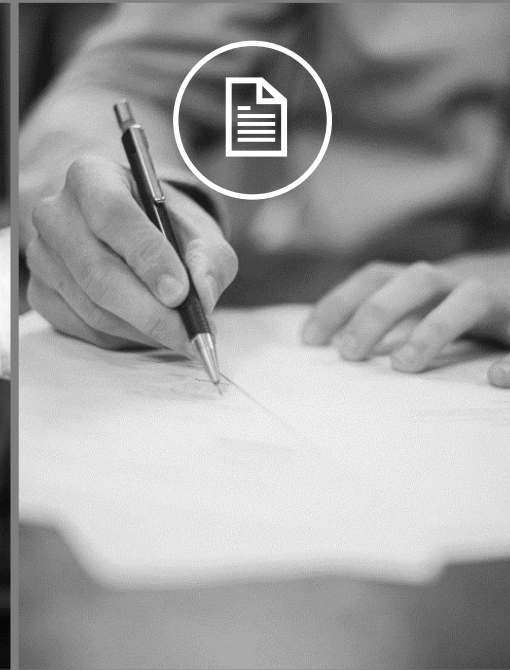
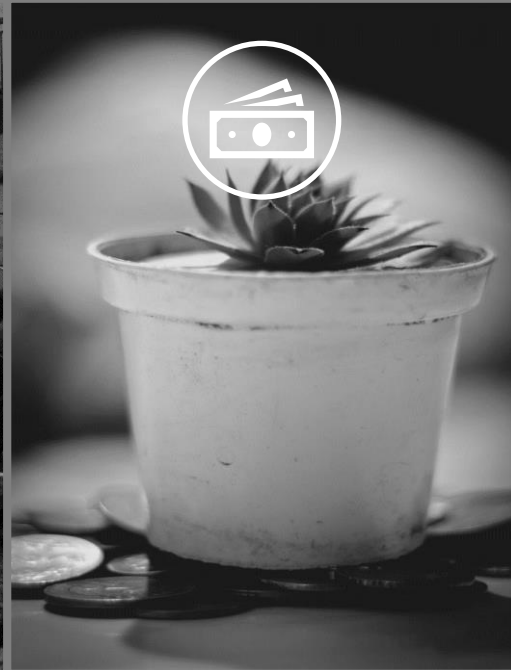
Diversify wherever possible, avoid concentration of clients/suppliers

Deposit Sales proceeds in Bank accounts, avoid cash

Plan finances ahead for the next 2-3 years as this may help achieve desired results

- 
- 1
 - 2
 - 3

Summarizing the discussion



A brief on MSMEs

- A large market size with a total of 63.4m MSMEs
- Contributes substantially to the GDP
- Makes for nearly half the country's exports
- Government acknowledges its importance and has a host of initiatives

Funding constraints

- Delay in loan sanctions and disbursements
- High interest rates
- Concern over collateral for working loan

Grading is instrumental

- Helps build credibility with stakeholders
- Provides access to funding at better credit terms
- Serves as a self improvement tool

Factors for grading

- Financial parameters such as revenue, profit, cash flow, capital structure
- Non-financial parameters such as industry analysis, competitive position, management competence

Compliant MSME

- A major differentiator that talks about the character of a business



THANK YOU!

Leveraging Knowledge,
Experience and
Technology to yield
Augmented Results

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