

Rating Methodology for SMEs in Mauritius

SME Ratings indicate the relative level of creditworthiness of an SME, adjudged in relation to other SMEs. It is an issuer specific rating reflecting overall general creditworthiness. It is a one-time assessment of credit risk. The rating exercise would take into account the industry dynamics, operational performance, financial risk characteristics, management capability and the future prospects of the entity for arriving at the overall risk profile of the SME unit. The rating methodology would be fine-tuned and appropriately modified so as to cover all the risk associated with each country in Africa. The detailed list of criteria is given below:

1.1. Industry Dynamics

1.1.1. Macro-economic Impact

There exists significant variation in macro-economic environment for countries within Africa. For some countries, key economic drivers are their natural resources (commodities); while for others the key economic drivers are their services (may be financial services, tourism etc.). Therefore, it would be imperative to understand and build into the methodology the vulnerability of local businesses to potential shock arising from changes in commodity prices, fluctuation in exchange rate, change in legal structure etc. CRAF would carefully analyze macro-economic developments and evaluate the possibilities of their impact on SME unit.

1.1.2. Industry Impact

No SME unit can isolate itself from the impact of industry dynamics. The industry parameters that affect an SME would include overall demand-supply scenario, competition level, and government support to the sector, cyclicity and seasonality of industry. Therefore, CRAF believes that promoters' ability to manage the business on industry impact is very crucial.

1.2. Operational Performance

Against the backdrop of the industry, CRAF assesses the entity's operating strengths and weaknesses vis-a-vis its competitors. SMEs having inherent strength and relatively strong positioning (including market share) in their business segment are viewed favorably in a credit perspective.

For assessing the business risk, long term sustainability of the business model is very important. Many SME units are part of some large group. In that case, the entity's importance and positioning within the group, its inter-linkages of operations and transaction transparency are also evaluated. In order to assess the smoothness of functioning of day to day operations, timely availability and sufficiency of raw materials, manpower (as many African countries face deficiency of skilled labor), utilities (non-availability of adequate electricity is one of the key constrained to business in some of the African countries) are analyzed with the major focus on locational and technological edge over others. The entity's initiatives for clean and green environment are also evaluated, during the site visit.

Business strength is derived by assessing customer profile, product profile, revenue mix and bargaining power with the stakeholders. An interaction with key customers and supplies also provides input for strength of relations with the rated SME unit.

1.3. Financial Risk analysis

CRAF believes that the quality of accounts is of prime importance as the significant part of financial risk analysis is based on the reported financial statements, disclosures and information submission. Audited financial results give more comfort than the unaudited / provisional results. CRAF believes that among the SMEs, limited companies have better accounting & disclosure systems as they need to follow regulatory and specific accounting guidelines.

CRAF evaluates financial flexibility (through gearing ratios, debt protection ratios and hybrid ratios), liquidity (measured by current & quick ratio, proportion of liquid assets, operating cycle, working capital management, cash flow from operating activities, etc.), business efficiency & profitability (indicated by turnover ratios, profitability ratios, return ratios, growth ratios, etc.). While evaluating gearing ratios for SME units, CRAF also sees the proportion of bank funds (excluding unsecured loans by promoters, friends and relatives) as dependency on external funds may be lesser in certain SMEs, which is considered as credit positive.

In order to evaluate the track record and relations with the banks, CRAF team interacts with the bankers / lenders to know overall conduct of account. Cash flow analysis is the most important parameter for assessing the creditworthiness.

1.4. Management Capability & Risk

CRAF critically evaluates quality of management as one of the most important parameters that supports the credit strength of an SME unit. CRAF team interacts with the SME promoters / key management personnel for understanding their business insight, vision, future growth strategy and approach towards the perceived risk factors. Most SMEs are family managed entities and highly dependent on single person. To assess the depth of the management, CRAF analyses the quality of the second line management, succession planning, organization structure and internal control systems.

Promoters' experience in business (including within the relevant industry sector) and track record of operations of the rated entity would act as key criteria for assessing management competence. CARE believes that the management having experience of several business cycles and familiarity for project implementation would have an edge. Management's skill to expand clientele, new trade initiatives and level of priority to the finance function are equally vital.

1.5. Project Risk Analysis

High level of project risk can also affect the financial strength of an SME unit, which can be assessed by project feasibility, size, and project gearing and stabilization issues, post implementation. CARE gives weight promoter's track record in project implementation and status of project including achievement of financial closure.

1.6. Explanation to Rating Scale:

As explained earlier that the rating of SME is an indication of its relative level of creditworthiness adjudged in relation to other SMEs in particular country. Thus, the rating scale for SME's would be country specific. The grading terminology for each country would arrive in following manner:

First word for rating would denote the name of rating agency – (i.e. CARE Ratings)

Second word for rating would denote the initial for country – (i.e. 'MRU' for Mauritius)

Third word of the rating would denote the allocated rating – (i.e. SME 1 to 8)

Therefore, if a SME in Mauritius is allocated the rating of '**SME 3**' then its rating would be '**CARE MRU SME 3**'. The following Rating Scale is proposed for SME Ratings in Mauritius:

SME Rating	Definition
CARE MRU SME 1	The level of creditworthiness of an SME, adjudged in relation to other SMEs is the Highest
CARE MRU SME 2	The level of creditworthiness of an SME, adjudged in relation to other SMEs is High
CARE MRU SME 3	The level of creditworthiness of an SME, adjudged in relation to other SMEs is Above Average
CARE MRU SME 4	The level of creditworthiness of an SME, adjudged in relation to other SMEs is Average
CARE MRU SME 5	The level of creditworthiness of an SME, adjudged in relation to other SMEs is Below Average
CARE MRU SME 6	The level of creditworthiness of an SME, adjudged in relation to other SMEs is Inadequate
CARE MRU SME 7	The level of creditworthiness of an SME, adjudged in relation to other SMEs is Poor
CARE MRU SME 8	The level of creditworthiness of an SME, adjudged in relation to other SMEs is the Lowest . Such entities may also be in default .

Disclaimer

CRAF's ratings are opinions on credit quality and are not recommendations to sanction, renew, disburse or recall the concerned bank facilities or to buy, sell or hold any security or to invest in or withdraw funds from deposits. CRAF has based its ratings on information obtained from sources believed by it to be accurate and reliable. CRAF does not, however, guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Most entities whose bank facilities/instruments/deposits are rated by CRAF have paid a credit rating fee, based on the amount and type of bank facilities/instruments/deposits.

In case of partnership/proprietary concerns, the rating assigned by CRAF is based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors.