REVIEWED

RATING CRITERIA FOR SMALL AND MEDIUM ENTERPRISE

DEFINITION OF SME

WCRCL has defined SMEs as accordance with the Bangladesh Bank SME and Special Programs Department Guideline on SMESPD Circular- 02 dated on 05 September 2019. In the definition, SMEs are categorized into two broad areas: manufacturing and service on the basis of fixed assets (excluding land and building) and number of workforce. The latest criteria for SMEs as given by Bangladesh Bank are given below:

A. Small Enterprise		
	Fixed Asset* (BDT in Million)	Number of Employee
Manufacturing Industry	7.50 – 150.00	31 - 120
Service Industry	1.00 - 20.00	16 - 50
B. Medium Enterprise		
Manufacturing Industry**	150.00 – 500.00	121 - 300
Service Industry	20.00 – 300.00	51 - 120

* Fixed Asset would be Excluding Land and Building.
** For RMG or Labor Intensive Industry maximum number of Employee would be 1,000.

WCRCL RATING SCALE

WCRCL has symbolized and defined Small and Medium Enterprise Rating separately from Corporate Rating. We are issuing only Long Term Rating to consider the nature of finance and business operation. WCRCL has been assigning Rating WCRME 1 to WCRME 8 for Medium Enterprises and WCRSE 1 to WCRSE 8 for Small Enterprises according to Bangladesh Bank Guideline. WCRCL Small and Medium Enterprise Rating Scale and Definition is denoted below:

RATING NOTCHS	MEANING OF THE RATING NOTCHS
WCRME 1/ WCRSE 1	Assigned rating is adjudged highest level of credit worthiness in relation to other SEs/MEs.
WCRME 2/ WCRSE 2	Assigned rating is adjudged high level of credit worthiness in relation to other SEs/MEs.
WCRME 3/ WCRSE 3	Assigned rating is adjudged above average level of credit worthiness in relation to other SEs/MEs.
WCRME 4/ WCRSE 4	Assigned rating is adjudged average level of credit worthiness in relation to other SEs/MEs.
WCRME 5/ WCRSE 5	Assigned rating is adjudged below average level of credit worthiness in relation to other SEs/MEs.
WCRME 6/ WCRSE 6	Assigned rating is adjudged inadequate credit worthiness in relation to other SEs/MEs.
WCRME 7/ WCRSE 7	Assigned rating is adjudged poor credit worthiness in relation to other SEs/MEs.
WCRME 8/ WCRSE 8	Assigned rating is adjudged lowest level of credit worthiness in relation to other SEs/MEs. Such entities may also be in default.

SME RATING CRITERIA

The criteria report contains all the factors affecting the creditworthiness of an SME issuer while assessing the creditworthiness of the issuer, the following are the main factors that are analyzed into detail by WCRCL.

1. Industry Risk Analysis
2. Business Risk Analysis
3. Management Risk Analysis
4. Financial Risk Analysis
5. Lender Relationship Risk Analysis
6. Collateral Risk Analysis
7. Covid-19 Impacts
8. Other Factors

INDUSTRY RISK

WCRCL evaluates the industry risk by taking into consideration various factors like strength of the industry prospect, nature and basis of competition, demand and supply position, structure of industry, pattern of business cycle etc. How the industry players are competing with each other on the basis of price, product quality, distribution capabilities etc are also analyzed. Industries with stable growth in demand and flexibility in the timing of capital outlays are in a stronger position and therefore enjoy better credit rating.

BUSINESS RISK

Under business risk, WCRCL assesses the sustainability of the business plan and the long-term viability of the unit. This comprises qualitative assessments of the track record of the business, the profile of the rated entity's customers, relationships with customers and suppliers, and the level of infrastructure and technology of the business.

In order to assess the SME's business risks, WCRCL contacts the promoters of the SME to understand their business plans and growth strategies. Most SMEs form part of larger industries' value chains and are usually not in direct contact with the end users. Moreover, in most industries, the degree of competition is high owing to factors such as the presence of a large number of players, low capital intensity and, in some cases, low technology levels. Hence, SMEs rarely have control over pricing. An SME's pricing flexibility stems from its relationship with key customers and its strong control over costs. For SMEs, control over costs is a function of the quality of technology and manufacturing facilities, and relationships with employees and suppliers. Assessing the quality of an SME's relationships with its key customers is a critical part of assessment of an SME; this parameter is assessed by directly contacting the entity's key customers. To assess the entity's manufacturing facilities, WCRCL insists on a visit to the facilities, either by a team of WCRCL analysts, or by WCRCL's business associates. WCRCL also contacts the SME's key suppliers to assess the quality of their relationships with the SME being rated.

Favorable location advantages, management and labor relationships, cost structure, availability of raw-material, labor, compliance to pollution control programs, level of capital employed and technological advantages etc. affect the operating efficiency of every issuer enterprise and hence the credit rating.

The size of business of a enterprise is a relevant factor in the rating decision. Smaller companies are more prone to risk due to business cycle changes as compared to larger companies. Smaller companies operations are limited in terms of product, geographical area and number of customers. Whereas large companies enjoy the benefits of diversification owing to wide range of products, customers spread over larger geographical area. Thus, business analysis covers all the important factors related to the business operations over an issuer enterprise under credit assessment. WCRCL evaluate the market standing of an enterprise regarding- market share, competitive advantages, selling and distribution channel, diversity of products, customers base, developing market positioning of new product as well as obsolete products, quality Improvement programs etc.

New addition in product portfolio or business line may raise high level of project risk that may affect prospective cash flow of the enterprise, capital structure, managerial expertise, financing risk and stabilization issues in operational phase. In WCRCL's view, promoter's past experience and project status including financial closure are equally considerable.

MANAGEMENT RISK

Quality of management is one of the most important parameters that support the credit strength of an SME unit. WCRCL team interacts with the promoters / key management personnel of the SME unit 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 a single person. WCRCL assesses the presence and quality of second line of management, apart from aspects related to succession planning, organization structure and internal control systems.

Promoter's experience in business (including within the relevant industry sector) and track record of operations within the rated entity would act as key criteria for assessing management competence. WCRCL believes that the management having experience of more than one business cycle and familiarity with project implementation would have an edge. Management's skill to add more clientele, new trade initiatives and level of priority to the finance function are equally vital. Promoter's connivance with related or identical business also taken into consideration as this business may also enjoy or avail same quantity of borrowed fund to operate issuer entity. We also take into consideration the strategies/ plan taken for capability enhancement of the management.

FINANCIAL RISK

WCRCL believes that the quality of accounts is of prime importance as the starting part of financial risk analysis is the reported financial statements and related disclosures. In this regard, audited financial results give more comfort than the unaudited / provisional results. Among the SME units, limited companies tend to have better accounting & disclosure systems as they need to follow regulatory and specific guidelines. In specific legal firms like partnership and proprietorship concerns, risk of withdrawal of capital always exists.

WCRCL evaluates financial flexibility of an SME (through gearing ratios, debt protection ratios and hybrid ratios), liquidity (measured by current & quick ratio, proportion of liquid assets, operating cycle, cash cycle, working capital management, cash flow from operating activities, etc.), business efficiency & profitability (indicated by turnover ratios, profitability ratios, return ratios, growth ratios, etc.). Cash flow analysis assumes critical significance while assessing the creditworthiness of a borrower.

The historical financial analyses considered by the WCRCL are:

- Trends: sales, profitability (ROCE, operating profit, PAT), debt-equity, debt protection cover (interest coverage ratio; debt service coverage ratio).
- Operating efficiency: cost as a percentage of sales, productivity per employee etc.
- Margins: Operating profit margins, PAT margins etc.
- Liquidity: Current ratio, quick ratio, inventory days, receivable days, payable days, working capital days, inventory's turnover ratio etc.
- Return Measures: Return on net worth, ROCE, Return on assets etc.
- Solvency: Debt/Equity mix, debt service coverage ratio, interest coverage ratio etc. These factors are compared with the nearest peers to find the relative risk standing.

LENDER RELATIONSHIP RISK

WCRCL team also interacts with the lenders/ bankers to learn about the loan facilities, tenure & usage, utilization of loan and performance of payment, overdue or rescheduling history, reason against the overdue or rescheduling, security against the loan, control over and quality of the security, and related issues. Restructuring of an obligation or loan classification will considerably disadvantageous to the creditors.

COLLATERAL RISK

Credit rating as well as the lender will be driven by collateral which is kept against loan obtained. Quality of collateral and security against the loan obtained must be confirm by respective analyst and may give a comfort in case of lien of FDR, hypothecation, guarantee, collateral, third party guarantee etc. against the loan, while assigning the rating.

COVID-19 IMPACTS

The rapid and widening spread of the Coronavirus outbreak, deteriorating economic outlook and created a severe and extensive credit shock across many sectors, regions and markets. The combined credit effects of these developments are unprecedented. WCRCL's recognizes the coronavirus outbreak as a social risk and it has substantial implications on business. WCRCL views more broadly relating to COVID-19's effects on markets, issuers and investors is ongoing, we have several initial observations concerning ratings actions, procyclicality and financial stability. In response to the broad and varied effects and unparalleled response to COVID-19, WCRCL have made, and continue to make, adjustments to the analytical assumptions and other inputs at the time of assigning and maintaining ratings.

OTHER FACTORS

Micro level factors or macro level factors as well as regulatory and legal various factors like-impact of changes in tax proposition, environmental embargo, and technological development in the industry may cause obsolescence of existing, inadequate insurance coverage or non-insurance, even changes in international regulation also consider during assessment of the rating.

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