



# Approach for SME Ratings in Maldives

**CARE Ratings Maldives**  
Professional Risk Opinion

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## Rating Approach for SME Ratings in Maldives

### Background

Maldives, though a small island economy, is one of the fastest growing in the world, driven by two leading sectors of tourism and fishing. These sectors have also given a hand to subsectors like local handicrafts, transport, boatbuilding, agriculture, construction & real estate and other tourism based allied services, which are essentially Small and Medium Enterprises (SME). SME segment being an important element for the Maldives economy, also provides good opportunity for further growth, provided some of the basic business constraints are addressed.

The Investment Climate Assessment (ICA) of the Maldives points to a number of areas in the operation businesses that require attention (World Bank, 2006). Out of the top five obstacles identified by the businesses surveyed, (i) lack of access to finance and (ii) high cost of finance were in topmost category. In fact, these are also the major hindrances to businesses in the SME segment. As a move targeted to address this issue, CARE as the only rating agency in Maldives at present, proposes to launch SME Rating product. The credit risk assessment in this segment requires a specific approach, as the factors affecting the creditworthiness are somewhat dissimilar compared to large corporate entities. Hence, to further support the growth for this sector and help the investors to determine the relative creditworthiness of entities belonging to this segment, CARE's SME Ratings will play a helping hand.

### **Rating Methodology**

SME Ratings indicate the relative level of creditworthiness of an SME entity, adjudged in relation to other SMEs. It is an issuer specific rating reflecting overall general creditworthiness. It is a onetime 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 detailed list of criteria is given below:

- **Industry Dynamics**

- ♦ **Macro-Economy Impact**

The Maldives is a small open economy and is, therefore, vulnerable to potential shocks, including changes in tourism flows, fluctuations in the prices of key commodities, such as food and fuel (both of which are mainly imported), and capital inflows. The country's revenues and foreign exchange reserves are directly or indirectly tied to the performance of tourism and any changes to tourism arrivals can undermine macroeconomic stability, which can have impact on the SME unit. CARE would carefully analyze macro economic developments and evaluate the possibilities of their impact on SME unit.

- ♦ **Industry Impact**

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

- **Operational Performance**

Against the backdrop of the industry, CARE assesses the entity's strengths and weaknesses vi-a-vis its competitors. Many SMEs have inherent strength and relatively strong positioning (including market share) in their business segment, which is considered as credit positive.

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, owned premises (as Maldives has shortage of land), timely availability and sufficiency of raw materials (as Maldives depends on imports for some important items), manpower (as there is shortage of skilled labour), utilities (high utility prices is among the top external business constraints as cited by entrepreneurs ) are analyzed with the major focus on locational and technological edge over others. Entity's initiatives for clean and green environment are also evaluated, during the plant 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.

▪ **Financial Risk analysis**

Maldives lacks extensive coverage of audit of accounts. CARE 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. CARE believes that among the SME units, limited companies have better accounting & disclosure systems as they need to follow regulatory and specific accounting guidelines.

CARE 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, CARE 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 SME entities, which is considered as credit positive.

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

▪ **Management Capability**

CARE critically evaluates quality of management as one of the most important parameters that supports the credit strength of an SME unit. CARE 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, CARE analysis the quality of the second line management, succession planning, organization structure and internal control systems. Promoter's 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.

▪ **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.

**CARE Maldives SME Rating Scale**

The following Rating Scale is proposed for SME Ratings in Maldives:

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

*The rating outcome is ultimately an assessment of the above factors and their linkages to arrive at the overall assessment of credit strengths and weaknesses by taking into account industry's cyclicalities. While the methodology encompasses comprehensive technical, financial, commercial, economic, and management analysis, credit rating is an overall assessment of all aspects of the issuer.*

**Disclaimer**

CARE's SME 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. CARE has based its ratings on information obtained from sources believed by it to be accurate and reliable. CARE 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 rated by CARE have paid a credit rating fee, based on the amount / size.

Head Office	Maldives Office
Credit Analysis & Research Ltd. 4 <sup>th</sup> floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai 400 022. INDIA. <a href="mailto:care@careratings.com">care@careratings.com</a> <a href="http://www.careratings.com">www.careratings.com</a> Phone: +912267543456 Fax: +912267543457	Credit Analysis & Research Ltd. 4th floor, Champa Center Point, Gold Hill Building, Chandhanee Magu, A U ` Y Ñ ž ` F Y d i V ` ] W ` c Z ` . <a href="mailto:care@careratings.com">care@careratings.com</a> <a href="http://www.careratingsmaldives.com">www.careratingsmaldives.com</a> Phone: +960 3330560/61 Fax: +960 3330562
Management	
Mr D.R. Dogra Managing Director & CEO <a href="mailto:dr.dogra@careratings.com">dr.dogra@careratings.com</a> Phone: +91-2267543434 (D) Mobile: +919820416002	Mr Rajesh Mokashi Dy. Managing Director <a href="mailto:rajesh.mokashi@careratings.com">rajesh.mokashi@careratings.com</a> Phone: +912267543636 (D) Mobile: +919820416001
Business Contact	
Mr P.N. Sathees Kumar Executive Vice President <a href="mailto:sathees.kumar@careratings.com">sathees.kumar@careratings.com</a> Phone: +912267543555 (D) Mobile: +919820416004	Mr Mehul Pandya Sr. Vice President <a href="mailto:mehul.pandya@careratings.com">mehul.pandya@careratings.com</a> Phone: +917940035587 (D) Mobile: +919824256265
Mr L. Vidhya Sagar Head Ì Maldives Operations <a href="mailto:vidhya.sagar@careratings.com">vidhya.sagar@careratings.com</a> Mobile: +9609848744	Ms Aishath Arsha Manager <a href="mailto:aishath.arsha@careratings.com">aishath.arsha@careratings.com</a> Mobile: +9607901855