

# GRADING METHODOLOGY

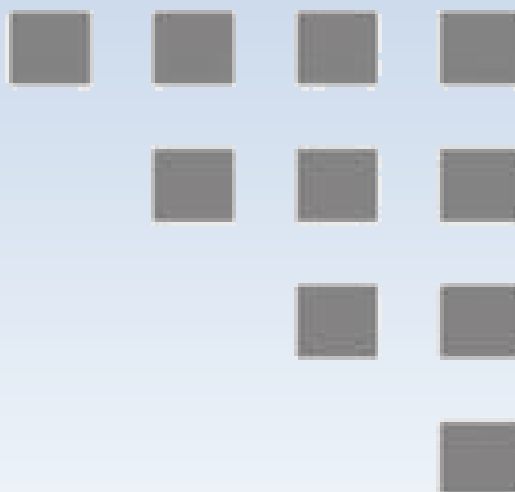
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## SECURITY AGENCY GRADING

*An opinion on the relative ability of the security agency to provide protection services as per agreement.*

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**0. INTRODUCTION**

- *Background*
- *Importance of Grading*
- *Grading Methodology Framework*
- *Grading Approach*

**0.0 Background:** Security Agencies (SA) provide a host of services to prevent and protect client’s life and property from damage. These services range from electronic surveillance and armed protection to convoy escorting. SAs are responsible for creating significant employment opportunities because of their personnel heavy nature of job. One common theme in recruitment is preference of SAs to engage law enforcement background (serving and retired) staff throughout the world. Developed countries, with mature security industry, have laws and regulations that govern this business to clearly define the role and authority of SAs. Moreover, international best practices exist for the industry in the form of code of conduct.

**0.0.1** The events of 9/11 and advancement of technology has led many institutions and individuals to rethink their security strategy. This includes both physical and digital security. Although many firms have kept the digital security in-house due to sensitive nature of the data, there is an increasing trend to outsource physical security to specialized firms. This has allowed SAs to expand and operate at a global level. Some of the main users of security services include financial institutions, business that involve cash transactions, and premises with a lot of public visitors (airports, sporting avenues, etc.).

**0.0.2** In Pakistan, security agency business traces its roots back to early 1980s when some of the first SAs were established and registered. SAs in Pakistan offer limited services as compared to their international counterparts. With financial institutions as main clientele of the industry, armed guards and cash in transit are the main revenue generators. SAs are gradually introducing digital surveillance and monitoring to their product slates. The worsening law and order situation in the country has increased the demand of security services at both institutional and individual levels. This has led to an influx of companies in this arena with number of registered SAs estimated to be over 250 now. The industry largely has a fragmented structure. Moreover, there are not many international security agencies operating in the country, and a few have even taken exit from the market. As a result, some of the best practices these SAs follow have not been implemented in Pakistan.

**0.1 Importance of Grading:** SAs operate under applicable Federal and Provincial regulations but these are basic in nature. Although SAs maintain minimum standards required under the law, the level of security services provided is not uniform. There is no independent mechanism or system that differentiates SAs based on their ability to provide protection services. Any unfortunate event of theft or robbery remains isolated and does not become part of a database or public knowledge. This absence of information and lack of disclosure causes difficulties for clients in picking the best SA for their needs. This has created negative perceptions about the industry in general. An independent and credible opinion in this regard will improve service standards and transparency in the industry. The relative distinction provided by such an exercise should serve to increase acceptability of better SAs.

**0.2 Grading Methodology Framework:** PACRA has developed a comprehensive methodology to assess the ability of SAs to provide protection services as per agreement. This methodology draws upon extensive research, interaction with the market players and other participants of the industry, international best practices, and incorporates local perspective. The basic objective of this methodology is to delineate PACRA’s grading process by clearly specifying the relevant factors underlying the grading of SAs. Along with the methodology, PACRA has developed an appropriate grading scale on which SAs will be placed. The scale along with definitions is annexed.



**0.2.1 Security Agency Grading** will ascertain the “ability of a company to provide protection services”. The eventual grading will establish the relative standing of the SA

among peers. Our opinion is wholesome in nature. This should not be construed as opinion on a guard but rather on the overall operations of a SA.

**0.2.2** PACRA will evaluate various qualitative and quantitative factors to determine the quality of protection services provided by a particular SA. These are 1) Profile, Ownership & Governance Framework, 2) Management Quality, 3) Infrastructure Adequacy, 4) Security Personnel Profile & Performance, and 5) Financial Sustainability.

**0.2.3** PACRA follows a top-down approach to analyze these factors both on a standalone basis and in unison to form a holistic opinion. Each of the factors depicted above encompass a number of sub-factors necessary for formulating the grading opinion.

**0.3 Grading Approach:** Grading is relative in nature. This implies that stand-alone performance of one SA has to be compared to industry practices and, where applicable, peers in order to arrive at a score for each grading factor. PACRA uses the factors explained in this methodology to ascertain how well the SA has performed independently. PACRA then draws relative distinction on two accounts, (i) performance against local standards, and (ii) adoption of international security services industry standards and best practices.

**0.3.1** PACRA assesses SAs to determine whether it has outperformed, equaled, or underperformed local peers. For this purpose, we use industry-wide benchmarks and standards for comparison. PACRA then recognizes those SAs which have gone beyond the minimum standards and adopted any international best practices. This allows PACRA to establish relative distinction between different SAs.

**0.3.2** Each factor carries a respective weight in the overall grading. One important distinction that PACRA draws is where the SA stands in its lifecycle. The position dictates the criticality of factors. For instance, financial sustainability is more critical for a newly formed SA as against a relatively established peer. Hence, this could be a binding factor for the new SA, capping its grading to a certain category.

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## 1. PROFILE, OWNERSHIP AND GOVERNANCE

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**1.0** We understand that in many SAs, the ownership, governance, and management will be dominated by same set of individuals. However, the clarity about different requirements of these roles is crucial.

**1.1 Security Agency profile:** The objective of this factor is to understand the SA’s operations at commencement of the grading exercise. The methodology assesses the number of years the SA has been in operations, its size, and the types of services it offers. PACRA gives due consideration to the mission, vision and values of the SA. We strive to ascertain the degree to which these have been accepted and followed in letter and spirit throughout the organization.

**1.2 Ownership:** Assessment of sponsor is a vital element in the grading process. PACRA gauges sponsor’s ability and willingness to provide support to the SA. Support could be in terms of business acumen or financial muscle of the owners. For this purpose, it is critical to identify the sponsor or man at the last mile. The sponsor is one who is expected to provide support in times of crisis. Usually within SAs, the ownership structure is not very complex and it is easy to identify the sponsor. PACRA looks at factors such as sponsor’s association to the SA, financial strength, and experience and expertise in the field of security provision, to determine the ability and willingness to provide requisite support. Another aspect looked at closely is the succession of ownership. Although this might not be a critical issue in certain SAs, it might have a significant bearing on grading of others.

**1.3 Governance:** This refers to the framework through which a company is controlled and run. PACRA analyzes the independence of board from management and sponsor, role of the BoD and various committees (if any), their interaction with the management, and ability to provide oversight. Consideration is given to areas which are discussed in board meetings to assess whether key risks are being identified and addressed accordingly. An effective board has an optimal mix of expertise and independence.

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## 2. MANAGEMENT

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- *Management Profile*
  - *Organizational Structure*
  - *MIS*
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**2.0** This is one of the key differentiating factors in the security services business, as management is responsible for running day-to-day operations of the SA. It formulates the business strategy, develops policies and procedures, and ensures execution.

**2.1 Management Profile:** PACRA assesses the experience and educational profiles of top management. Related experience, especially law enforcement, is given a higher weightage. The understanding of management personnel of relevant laws and regulations is considered an important grading factor. PACRA seeks to gauge the role of senior management in developing and implementing organizational policies. This is an important factor as these policies determine how well the organization operates.

**2.2 Organizational Structure:** PACRA gives consideration to staffing and operations at both core and support departments at a SA. Core departments include the ones directly involved in delivery of security services, like Operations and Marketing. While support may include Internal Audit, Finance and Legal. There should be clear segregation of duties to avoid conflicts of interest at any level. Individuals should have appropriate authority and should be accountable for their work. Presence of effective management committees adds value to the organizational set-up, and is duly reflected in PACRA’s grading exercise. It is paramount to create depth in the management team, in order to avoid over-reliance on any one key individual.

**2.3 MIS:** One of the key tools available to the management to effectively run an organization is the information provided to it. PACRA closely monitors the type and frequency of information used by the management. The critical aspect is for the information to be concise, clear, and timely so the management can understand and respond accordingly. PACRA further assesses whether management has developed any critical success factors (CSF) to evaluate performance of various business segments. The efficacy of these CSF is gauged.

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### 3. INFRASTRUCTURE ADEQUACY

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- *Physical Facilities and Equipment*
  - *SOPs*
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**3.0** Infrastructure Adequacy is one of the most important factors considered in SA grading. It pertains to the availability of appropriate and necessary facilities required for a SA to operate effectively. This will have two dimensions: i) Physical facilities and equipment required for security services, ii) Established SOPs for various activities and their implementation.

**3.1 Physical Facilities and Equipment:** These include head office, round the clock operation room, requisite fixtures, computers and software, and training facilities. The overall operating environment and its efficacy for the security personnel are reviewed. PACRA gives weightage to use of technology to support operations as it mitigates human errors and brings efficiency within the SA. One of the important elements for a SA is the communication tools available on-site and in the head office or operations room. PACRA analyzes the adequacy of the equipment in light of SA’s operations.

**3.2 SOPs**

SOPs		
Sr.	Factors	Definitions
1	Emergency Response	Special consideration is given to processes involving emergencies at client sites. PACRA reviews the emergency check-lists and examines the effectiveness of the response plan devised by the SA. Presence of relevant contact numbers and written protocol at site, along with track record of response in various scenarios is assessed. Having robust processes and SOPs is important but it will not serve the purpose if these have not been effectively communicated to pertinent individuals. Hence, PACRA not only assesses the completeness of these processes, it gauges the mechanism through which SA communicates and regularly trains its staff. SAs which strive to go beyond the basics and solicit active feedback (from staff as well as clients) on their processes and update them in this light are viewed positively.

2	Issuance and Maintenance of Weapons	Weapons present a significant risk. Therefore, SA is required to have strong controls to govern their use and storage. PACRA reviews the weapons issuance protocol and log books to determine robustness of the issuance process. SA's framework for maintenance of weapons is critically observed. Further, on-site and head office weapons storage rooms are visited to assess how SA ensures there is no pilferage or unauthorized access.
3	Site Planning	PACRA assesses the SA's arrangement with the client. It is important to develop security plans for clients after due deliberations with them. SA's mechanism to regularly address and document client concerns and requirements is critical. PACRA will assess whether client feedback is analyzed to identify any trends, and if so, what actions have been taken in past to improve service delivery.
4	Procurement	This is a critical area for a SA. It involves purchasing necessary operational equipment and arms and ammunition. PACRA considers the procurement policy of the SA to assess if the suppliers are being effectively scrutinized in terms of their profile and value for money of their products. Long-term relationships with suppliers are given due consideration. Assessment of policies regarding buffer stock and maintenance of arms and ammunition form part of PACRA's analysis.
5	Disaster Recovery	SAs need to have in place a strong disaster recovery plan for its own operations. PACRA considers whether operations of SA can continue seamlessly, does the SA have back-up of soft data, are hard files secured and not accessible to unauthorized personnel and so on. The review mechanism of the plan and its efficacy is assessed.

#### 4. SECURITY PERSONNEL

- *HR Policies*
- *Security Guards Profile*

**4.0** It entails the quality of guards and, in turn, services provided to customers. A security guard's role is to prevent and protect people and their property. They are the face of any SA and have the most interaction with the clients. PACRA looks at how well equipped the guards are to handle their duties and what policies has the SA implemented to improve their performance.

##### 4.1 HR Policies

HR Policies		
Sr.	Factors	Definitions
1	Hiring	The most critical step for a SA is hiring of the security guard. This is the point where it can place ample checks and balances so no guard without proper checks and balances is engaged. PACRA not only assesses the presence of such checks but ensures whether they are being followed in true letter and spirit. SA which conducts physical and written tests and interviews along with external verification of credibility of guards is considered superior.

2	Duty	PACRA believes that HR policies governing work and related benefits are of importance. In this regard, their job descriptions, basic work conditions provided, perks and salary structure, evaluation criteria, and room to grow within the organization is assessed. The basic point is that SAs which take due care of its guards are in a better position to serve their clients effectively.
3	Trainings	The induction and ongoing trainings provided to guards is of paramount importance. PACRA looks at the areas covered, training provider, and frequency of training, under this sub-factor. Further, PACRA assesses the resources dedicated for this important activity as it displays the attitude of SA management towards proper training of its security guards. SAs which conduct a need assessment and plan their training calendar accordingly will score higher on this front.

**4.2 Security Guards Profile:** This area entails aspects such as physical appearance, expertise, and back ground of security guards. The feedback received from clients is reviewed. Guards may be monitored on duty by PACRA analysts through inspection of one or two sites where they are deployed. Security guards are expected to be alert and present at their respective stations at all times. Further, their physical appearance is considered important since they are the point of contact between client and SA.

## 5. FINANCIAL SUSTAINABILITY

- *Business Environment*
- *Diversification*
- *Financial Analysis*
- *Insurance Cover*

**5.0** Financial Sustainability refers to the financial health of a SA and its prospects to operate as a commercially viable entity. This is important as clients expect the SA they engage with to remain a going concern. It is pertinent to note that, if under stress, this alone will become a limiting factor for the entire grading.

**5.1 Business Environment:** PACRA assesses the operating environment and business prospects of SAs. Their ability to tap on this potential depends on the extent of competition in the industry and the SAs relative positioning. Currently, with over 250 registered SAs, the competition for business is stiff. PACRA considers factors such as market share, range of services, and customer loyalty to form view on competitive strength.

**5.2 Diversification:** This factor considers the sustainability and diversification of the revenue stream. SAs which generate its revenues through a wide range of products, clients, and from various regions, is more likely to be stable in longer-term.

**5.3 Financial Analysis:** In order to ascertain whether the SA is financially viable, PACRA looks at its revenues, profitability, cash flows, coverages and leveraging. Basic financial ratios like revenue growth, operating and net profit margins, EBITDA coverage, and debt-equity are used for this purpose.

**5.4 Insurance Cover:** The capacity of SA to meet commercial liabilities/damages if they occur is considered. PACRA analyzes the insurance coverage the SA has negotiated with insurance companies in contrast to the potential liabilities it may owe to clients. Quality of insurer in settling its claims in a timely manner is assessed.

## Security Grading

PACRA has designed a scale for security agency grading. The scale has five grading categories from “SG1” to “SG5” with SG1 being the highest. PACRA may append “+” sign to a grading to denote relative status within a grading category except for “SG1” and “SG5”. The standard grading scale and definitions are as follows:

Scale	Definition
SG1	<b>Very strong.</b> Ability to provide protection services as per terms of contract is considered very strong, while exceeding security services industry standards and best practices
SG2+ SG2	<b>Strong.</b> Ability to provide protection services as per terms of contract is considered strong, while meeting or exceeding security services industry standards and best practices
SG3+ SG3	<b>Good.</b> Ability to provide protection services as per terms of contract is considered good, while meeting security services industry standards and best practices
SG4+ SG4	<b>Adequate.</b> Ability to provide protection services as per terms of contract is considered adequate, while meeting majority of security industry standards and best practices
SG5	<b>Weak.</b> Ability to provide protection services as per terms of contract are considered weak, while being below security industry standards and best practice

<p><b>Outlook (Stable, Positive, Negative, Developing)</b> Indicates the potential and direction of a grading over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a grading change. ‘Stable’ outlook means a grading is not likely to change. ‘Positive’ it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.</p>	<p><b>Grading Watch</b> Alerts to the possibility of a grading change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from material identifiable event and/or b) deviation from expected trend. But it does not mean that a grading change is inevitable. A watch should be resolved within foreseeable future but may continue if underlying circumstances are not settled. Grading Watch may accompany Outlook of the respective opinion.</p>	<p><b>Suspension</b> It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the grading should be considered withdrawn.</p>	<p><b>Withdrawn</b> A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information.</p>	<p><b>Harmonization</b> A change in rating due to revision in applicable methodology or underlying scale.</p>
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**Surveillance.** PACRA shall not keep the Security Grading under constant surveillance. The grading will be assigned at least once every six months. Any material happening during a period that may warrant a revision of grading will be incorporated in the following review.

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