



CRISIL Governance and Value Creation Ratings

A brief note

Introduction

The absence of an accepted standard to evaluate the **effectiveness** of corporate governance has been a key concern facing stakeholders. The CRISIL Corporate Governance and Value Creation Rating (CRISIL GVC Rating) fully addresses this issue by providing an independent assessment of an entity's performance and future expectation on 'balanced value creation through sound corporate governance practices'. The CRISIL GVC Rating is a globally unique model, which appropriately balances quantitative value creation measures with qualitative evaluation, provides a view on the entity's expected performance in future and addresses all stakeholders more equitably. CRISIL believes that this path-breaking effort will place India amongst countries that have contributed materially towards better and effective corporate governance. A "CRISIL GVC Level 1" rating shall soon emerge as a widely respected symbol representing balanced value creation via sound corporate governance practices.

CRISIL GVC Ratings

CRISIL GVC Ratings provide an independent assessment of an entity's current corporate governance and value creation practices and an expectation on its future performance. The CRISIL GVC Rating is a powerful measure to adequately evaluate how a firm is performing on its *raison d'être* or primary purpose of existence, that is creating value for its owners and various stakeholders. CRISIL GVC Ratings are based on criteria from which the present condition and future progress can be accurately measured and analyzed. Such a measure ensures that two equally well-governed companies will not, *prima facie*, receive identical ratings if one is a significant value-creator while the other is destroying value.

Criteria

CRISIL evaluates two broad aspects to arrive at GVC Ratings for companies. These comprise:

1) Value creation and distribution

In this category, CRISIL looks at the company's track record in creating and distributing value amongst the various stakeholders in the system. The criteria are so constructed that the interests of various stakeholders are evaluated in a balanced manner, by appropriately assigning weights to individual stakeholders.

The stakeholders considered and an indicative list of the parameters used to evaluate respective value creation and distribution are:

- i) **Shareholders:** The measures used include return on invested capital compared to weighted average cost of capital, dividend payout ratio and the like.
- ii) **Debt Holders:** CRISIL looks at relative debt protection measures. These will include credit rating and upgrades in ratings, among others.

- iii) **Customers:** The parameters include market share, assessment of customer satisfaction and cost savings passed on to customers.
- iv) **Employees:** The parameters considered include absolute salary levels, adjusted growth in average annual salaries, employee stock options, attrition rates and intangible factors.
- v) **Suppliers:** The factors considered include the relative change in credit terms, passing on of increased realization and support to suppliers, among others.
- vi) **Society:** Here, the measures include total direct taxes paid, employment generated, expense on social infrastructure, environmental and social impact cost and fair practices.

2) Corporate Governance and Wealth Management:

Under this category, CRISIL looks at the company's capabilities and processes to ensure good governance, the checks and balances that it has instituted to prevent abuse of power, transparency of reporting, and the capabilities and robustness of the company's management.

The broad factors, which CRISIL uses to analyse the performance on this category are:

- i) **Assessment of management capabilities** including success of strategies, ability to re-strategize, track record of innovation and experience of management.
- ii) **Financial transparency and disclosure**, including independence & standing of the auditor, disclosure standards, timing of disclosures and the like.
- iii) **Influence of majority or large stakeholders**, including decision-making processes, evaluation of sources of receivables and destination of payables, and affiliate or group company transactions.
- iv) **Board composition and effectiveness** including the criteria for selecting board members, board meeting processes, information availability and timeliness, role and effectiveness of independent directors, board evaluation, compensation and succession policies.

Evaluation process

The evaluation is carried out only upon receipt of the mandate from the company; there are no unilateral evaluations. Before granting a CRISIL GVC rating, CRISIL carries out a detailed evaluation exercise on companies that wish to get themselves rated. The process comprises analyzing both information that is confidential and that which is in the public domain as well as having intensive interactions with the management personnel, board members, especially external directors, and representative of key stakeholders. The findings from this process are captured into a detailed report, which is presented to the rating committee, which then assigns the rating. The assignment is typically completed within three to four weeks from receiving the mandate. The ratings are confidential till accepted by the company.

Deliverables, Validity and Reviews

The deliverables from the CRISIL GVC rating process are a CRISIL GVC Rating on a scale of eight levels and a detailed write-up providing analysis and conclusions.

A CRISIL GVC Rating is valid for a period of one year from the date of assignment of the first rating. Thereafter, the ratings shall be reviewed annually or more frequently if the circumstances so warrant.

Benefits of CRISIL's GVC Ratings

Investors benefit from the CRISIL GVC Ratings in a number of ways:

- 1) CRISIL GVC Ratings identify companies that follow effective corporate governance practices. At the same time, these ratings also differentiate two equally well-governed companies on value creation throughout the chain.
- 2) Since it is a single comprehensive measure, the CRISIL GVC Rating and the accompanying analysis enable an investor to cut through the clutter of voluminous reports and filings and focus on core governance and wealth creation issues.
- 3) CRISIL GVC Ratings evaluate the treatment of various stakeholders by the management, presenting a more balanced viewpoint than traditional analysis
- 4) These ratings provide an independent insight into governance practices and their sustainability
- 5) Over a period of time, the aim is to create a single benchmark, which will bring about relativity and differentiation between well-governed companies and others

Companies too stand to gain from adopting the CRISIL GVC Ratings:

- 1) These ratings will help attract investors by highlighting the effectiveness of a company's corporate governance practices
- 2) Companies can also assess their existing status and capabilities and set up a road map for further improvements
- 3) CRISIL GVC Ratings help create visibility across all stakeholders
- 4) These ratings also serve as an independent opinion of the company's governance practices and their sustainability

Conclusion

CRISIL's GVC Ratings allow companies to benchmark their internal strengths and processes and differentiate themselves in increasingly competitive markets. Case studies clearly demonstrate the substantial value that is added by the CRISIL GVC ratings vis-à-vis an evaluation of only corporate governance practices or of value creation for a particular stakeholder alone. The benefits accrue equally to investors and to corporates submitting to the GVC rating process. CRISIL believes that GVC ratings shall become an important input in influencing the stakeholders' decision to invest and/or transact with companies.