CRISIL
An S&P Global Company

Criteria for notching up standalone ratings of companies based on group support

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Executive summary

Indian business houses have a history of operating several companies in diverse lines of businesses. A group of companies may be identified by the presence of common promoters, significant cross-holdings and sometimes, a shared name or logo. While assessing the credit quality of companies belonging to a group, CRISIL factors in the likely support that the companies may receive from the group. The benefit of a notch-up is, however, provided only to companies belonging to a group with a reasonably strong credit quality. CRISIL considers the presence of a clearly identifiable parent as more favourable than membership in a group. Therefore, while there is no restriction on notch-up for parent support, the extent of notch-up for group support is typically limited. CRISIL employs a framework to decide if a company belonging to a group is to be notched up, and the extent of it, for group support. The framework captures the degree of integration between the company and the group, and is based on a set of economic parameters, and factors that create a moral obligation on the group to support the company.

Scope

This criteria article pertains[1] to companies belonging to a group, held by common promoters or other companies in the group. In case of subsidiaries with a clearly identifiable parent, CRISIL adopts the methodology described in *'Criteria for notching up standalone ratings of companies based on parent support'*, which is available on the CRISIL website.

The criteria applies to large groups with operations in multiple sectors with a relatively complex holding structure. These have ability to raise resources based on their brand or reputation in the financial markets. Most companies in the group may be listed, and each will have a professional management and a strong, independent board. However, the promoters will retain a sizeable stake (could be as low as 30%), and exercise control over companies in the group and over the board.

The criteria may not be applicable to a homogenous corporate group, operating as one single entity, under a common promoter or promoter family. Many promoters or families run medium-to-small groups in one or two business segments, but with several companies. The reasons for operating several companies may include the following:

- Each company in the group may take care of a particular geography, market or one part of the value chain
- Opportunistic buying and selling of operations, with little or no strategic justification
- Segregation of roles of different family members
- Legal or tax reasons

Such companies will, however, have some common characteristics:

- High fungibility of cash flow between the companies and inter-company transactions
- Promoter control over operations and decisions, including what business to undertake, or which entity should execute a specific contract
- Companies in the group that are typically not listed in the equity markets

[1] This article has been updated to incorporate SEBI guidelines on rating symbol for instruments having explicit credit enhancement feature, as per its circular dated June 13, 2019. For the previous version of this article, which was published in August 2018, please refer to the link below: *https://crisil.com/content/dam/crisil/criteria_methodology/criteria-research/archive/Criteria-for-notching-up-standalone-ratings-of-companies-based-on-group-support-aug2018.pdf*

- Cross-guarantee of debt from one company to another

For more details on such homogenous corporate groups, please refer to *'Criteria for rating entities belonging to homogenous corporate groups'*, available on www.crisil.com.

Group support is factored into the ratings when the group company's debt is not explicitly guaranteed by another company in the group. If the instrument being rated is unconditionally and irrevocably guaranteed by another group company, backed by a payment mechanism, the rating of the instrument is equated to the rating of the guarantor, suffixed with the tag, CE (Credit Enhancement), to highlight the credit enhancement in the form of the guarantee and payment mechanism. For more details, please refer to *'CRISIL's Criteria for rating instruments backed by guarantees'*, available on www.crisil.com.

Assessing credit quality of group

The overall credit quality of a group is assessed to gauge its ability to support its members. The first step is to identify the companies that constitute the group. A company may be part of a group based on holdings by common promoters, investments by other companies in the group, or a shared name or logo. CRISIL also evaluates the promoters' and management's willingness to identify a company as a member of the group.

The group's overall credit profile is analysed by factoring in the financial, business and management risks of its major constituent entities. CRISIL also factors in diversity benefits from holdings in entities operating in multiple sectors, and the financial flexibility available to the group in the form of market value of its shareholdings.

The ability of stronger entities in the group to support other companies and the impact of such support on the overall credit quality of the group are evaluated. If the group's credit quality is pressurized on account of honouring the liabilities of weaker entities, it will impact the rating of the major constituents of the group.

Extent of notch-up

CRISIL employs its group notch-up framework to estimate the extent of notch-up to be provided to the standalone rating of a company. The framework assesses the level of strategic and financial linkages between the company and group, and is based on the following parameters: the economic rationale for the group to support the company; and, factors that create a moral obligation on the group to support the company (*Chart 1*).

Chart 1: Parameters for assessing extent of notch-up

A. Economic rationale	B. Moral obligation
A.1. Relevance of company to group	B.1. Extent of management control
A.2. Extent of shareholding by group / promoters	B.2. Shared name / common logo
A.3. Economic incentive to group	B.3. Commonality of resources
	B.4. Management's stated posture

A. Economic rationale

The following parameters are part of the economic rationale for a group to support a group entity:

A.1. Relevance of company to group: The relevance of a company to its group may be evaluated based on the relative contribution of the company towards the consolidated turnover and profits, commonality in lines of business, and criticality of the company to the group (whether the company is a critical supplier to other group companies or operates in a major growth market). The promoters' outlook on the company's business is also factored in during the evaluation.

A.2. Extent of shareholding by group/promoters (current and prospective): CRISIL notches up the rating of a company for group support when there is significant shareholding by the promoters or other group companies, because this reflects a greater commitment towards the company. CRISIL also takes into account holdings by other stakeholders, including dealers and employees, if their interests are aligned with those of the promoters.

A.3. Economic incentive to the group (current and prospective): If a firm is not profitable, its group may be reluctant to extend support beyond a point. But if a profitable firm falls into temporary distress, timely support by the group will prevent erosion of the economic value of the investment held by the group. CRISIL follows a forward-looking approach on the profitability of the firm, taking a medium-term view on the company's prospects, but balanced by its past performance. In case of companies in the project stage, the timeframe set for the company to break even and contribute positively to investments made by the group is also factored in when evaluating economic incentive.

B. Moral obligations

The following parameters constitute moral obligations on a group to support an entity:

B.1. Extent of management control: Extent of control exerted by the group on the company's board, the group's active involvement in managerial decisions and daily operations, sharing of systems and expertise between group and company, and the presence of a common treasury determine the extent of management control.

B.2. Shared name/common logo: A shared name between the group and company creates a moral obligation on the group to bail out the company in times of distress. Even in the absence of a shared name, integration of the company with the group may be manifested in the form of a common logo, or acknowledgement of group membership on public platforms, such as the company's website.

B.3. Commonality of resources: Market pressure in terms of common bankers, common location of operating units would increase the group's moral obligation to support the rated company. The pressure to bail out the rated company would also be high from the market, government and common lenders.

B.4. Management's stated posture: The track record of the group in extending financial support to group companies is considered an indicator of the management's stated posture. CRISIL may not notch up companies in a group if the track record of supporting group companies is unsatisfactory. Guarantees and assurances, such as letters of comfort, or shortfall undertakings from one or more group companies also reflect the group's commitment to the rated company.

Final rating of group company

CRISIL does not notch up the standalone rating of a group company if the strategic and financial linkages between the said parties are weak on evaluation of parameters listed in *Chart 1*.

In case of subsidiaries, it is possible to identify a single-parent entity that will provide distress support. However, if support is expected from a group of companies, it may not be possible to identify a single entity as the source of distress support, resulting in uncertainty regarding the extent and timeliness of support. Therefore, the extent of notch-up for group support is typically limited. This is in contrast to the notch-up of subsidiaries for support from a clearly identifiable parent, where no such restrictions apply.

Conclusion

CRISIL's group notch-up criteria factor in the ability and willingness of a group to support its group company in times of distress, depending on the strategic and financial linkages between the company and group. These linkages are captured in a framework, which is based on a set of parameters characterising the economic rationale for the group to support the company, the moral obligation on the group, and demonstrated track record of the group in supporting its companies. This framework is used to determine if, and the extent to which, the rating of a company is to be notched up for group support.

About CRISIL Limited

CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better.

It is India's foremost provider of ratings, data, research, analytics and solutions, with a strong track record of growth, culture of innovation and global footprint.

It has delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers.

It is majority owned by S&P Global Inc, a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

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