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

a) common promoters,
b) significant cross-holdings and
c) sometimes, a shared name or logo.

While assessing the credit quality of companies belonging to a group, CRISIL Ratings 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 Ratings considers the presence of a clearly identifiable parent as more favourable than being part of 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 Ratings employs a framework to decide if a company belonging to a group can 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 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 Ratings 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 and 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. These are typically termed homogenous group give high fungibility of cash flows, inter-company transactions and in certain cases, debt of companies are cross guaranteed.

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

[1]For the previous version of this article, which was published in Feb 2023, please refer to the link below:
https://www.crisilratings.com/content/dam/crisil/criteria_methodology/criteria-research/archive/criteria-for-notching-up-standalone-ratings-of-companies-based-on-group-support-feb2023.pdf

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 Ratings 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 Ratings 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 Ratings 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 and criticality of the company to the group's overall strategic interests. 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): This reflects a greater commitment towards the company. CRISIL Ratings 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 Ratings 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: 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: This 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 Ratings 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 Ratings 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 Ratings 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 Ratings Limited (A subsidiary of CRISIL Limited)

CRISIL Ratings pioneered the concept of credit rating in India in 1987. With a tradition of independence, analytical rigour and innovation, we set the standards in the credit rating business. We rate the entire range of debt instruments, such as, bank loans, certificates of deposit, commercial paper, non-convertible / convertible / partially convertible bonds and debentures, perpetual bonds, bank hybrid capital instruments, asset-backed and mortgage-backed securities, partial guarantees and other structured debt instruments. We have rated over 33,000 large and mid-scale corporates and financial institutions. We have also instituted several innovations in India in the rating business, including rating municipal bonds, partially guaranteed instruments and infrastructure investment trusts (InvITs).

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