Parent Support a Benefit During 2014 and 2015 Economic Slowdown

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Parent support a key factor

With higher interest rates and inflation, plus weaker exchange rates, maintaining asset quality has been a key focus for many companies dealing with softer business growth and profitability. Many companies, especially in the multifinance and banking industries, are struggling to maintain their asset quality at manageable levels, and even more are adjusting their growth forecasts, as those industries are very closely related to macroeconomic factors. PEFINDO rates 26 multifinance companies and 36 banks, of which 24% are in the AAA category, 27% in AA category, 36% in A category, and 13% in BBB category and below. Nearly all of those companies are in the stable outlook category, with six ratings having negative outlooks, while there is no rating with a positive outlook. There have been a few rating downgrades and outlook revisions in 2014 and 2015 in the two sectors (multifinance and banking), such as Bank Sumut ($_{id}$A/Stable from $_{id}$A+/Negative - 2014), Verena Multi Finance ($_{id}$A-/Stable from $_{id}$A/Stable - 2014), Bank Jawa Barat dan Banten ($_{id}$AA-/Negative from $_{id}$AA-/Stable - 2014), Bank Muamalat Indonesia ($_{id}$A+/Negative from $_{id}$A+/Stable – Sep 2015, and $_{id}$A+/Stable from $_{id}$AA-/Stable – Apr 2015), Bank Mayapada Internasional ($_{id}$A-/Negative from $_{id}$A-/Stable - 2015), Bank DKI ($_{id}$AA-/Negative from $_{id}$AA-/Stable - 2015), and Bank Papua ($_{id}$A-/Stable from $_{id}$A/Negative – Oct 2015, and $_{id}$A/Negative from $_{id}$A/Stable – Jun 2015).

The difficult economic conditions have been going on for longer than initially expected and are testing the strength of our parent support methodology. Our analysis indicates that some companies have in fact done well in these testing times, visibly better than their counterparts. Some have grown their market share, effectively grabbing a greater share from their competitors. We attribute these better performances to the strength of parent support integrated into their businesses. This support has either allowed the subsidiaries the extra liquidity and flexibility to expand at the expense of their competitors, or the parent-subsidiary business integration has provided more access to better quality customers, enabling them to withstand economic fluctuations with better results. This was reflected by several rating upgrades in 2014 due to stronger confidence on the likelihood of support from the parent, such as Bank Permata Tbk, Astra Sedaya Finance, and Federal International Finance, with each raised by one notch to $_{id}$AAA/Stable from $_{id}$AA+/Stable, while Toyota Astra Financial Services' rating was also upgraded by one notch to $_{id}$AA+/Stable from $_{id}$AA/Stable.

Two main elements of parent support methodology

PEFINDO's parent support methodology has two main elements: the parent's capacity, and their willingness. Assessing capacity usually focuses on quantitative measurements, so it is more straightforward as there are supporting figures from the financial statements that can be carefully calculated and measured. Assessing the willingness of a parent company involves a more qualitative analysis and judgment, and the qualitative analysis is closely related to the management's vision, goals, and risk appetite, which can be very different from one company to another, thus adding to the complexity of the analysis. Although a track record of support helps determine the willingness of the parent, the policy of support may still change in the future, thus presenting an element of uncertainty for the analysis.

In assessing the parent's capacity, PEFINDO begins by analyzing the parent's financial statements. If the parent is an operating company, then PEFINDO analyzes its business and financial performance. However, if the parent turns out to be a holding company, then its capability will be determined by the credit strength of its subsidiaries that make substantial contributions. Here, we are trying to establish whether the parent has sufficient capacity to provide support, especially during difficult times, and how much stronger its financial capacity is against that of the subsidiary. If it is confirmed that the parent's financial capacity is substantially stronger, then it is qualified to provide support to its subsidiaries, in terms of its capability.

In the case of the parent's capacity not being confirmed (since its capacity is not that much stronger), or because of a significant lack of information to determine the parent's financial capacity, PEFINDO will then assign the rating for the subsidiary based on its standalone credit profile. At this stage, an analysis of the parent's willingness will be less relevant as its capacity is unclear.

However, if the parent passes the capacity test analysis, the next step will be to conduct the willingness to support assessment. There are several factors that can contribute to the assessment, such as contribution, ownership, business integration, and reputation. All these factors are very important in measuring the parent's willingness to support its subsidiaries.

Three categories of parent support

PEFINDO classifies parent support into three classes: core subsidiary, strategically important subsidiary, and non-strategic subsidiary. In determining the likelihood of support, PEFINDO considers the factors mentioned above and assesses important questions relating to the parent-subsidiary relationship. Here are some examples of the process. In terms of contribution, PEFINDO assesses how the failure of the subsidiary will impact the parent's credit profile. Will it have a significant, moderate, or minimum impact? How will the failure affect the parent's market presence, brand image, and financial performance? In terms of ownership, we try to gauge the type of control and interest that the parent maintains in the subsidiary. Changes in ownership can signal its intentions and strategy regarding the subsidiary.

Likewise in terms of business integration, we review how closely the integration between the parent and subsidiary is, and what will be the fallout if such integration stops. This is related to the reputation factor. For example, a much stronger parent may not obtain a significant contribution from its subsidiary, but a strong integration of operations, network, and IT systems, may indicate the parent's strong willingness to support, since those integrations are not easy to change. An abrupt change may also hurt the parent's reputation and brand image, thus the sharing of its business systems, infrastructure and brand can be a sign of its strong indication to provide support. One example is a strong parent letting its much smaller subsidiary use its name and business channels and infrastructure to conduct business with other parties.

Characteristics of parent support categories

Core subsidiary is the highest degree of support that PEFINDO assigns, meaning that the final rating of the subsidiary should be close or the same with the parent, depending on several criteria. In this case, PEFINDO assigns the final rating to the subsidiary using the parent's rating as the base rating. A core subsidiary will be more than likely to meet all or most of the criteria described above, in which the relationship is very much intertwined.

Strategically important subsidiary is the second degree of parent support, in which PEFINDO views that the subsidiary is important to the parent's overall strategy, but not as important as a core subsidiary. A few indicators may be of an insignificant contribution to the parent, or lack of business integration, or a failure of the subsidiary may not have a considerable impact on the parent's performance. In addition, there may be the possibility for the parent to divest its stake in the subsidiary, or to replace the function of the subsidiary with another. In this case, PEFINDO will use the standalone rating of the subsidiary as the base, and then assign the notching up from the parent support. The maximum notching up is limited to three.

A non-strategic subsidiary is considered a passive investment, and could be sold within the near to intermediate term. In most cases PEFINDO will not assign any notching up, but will assign the final rating based on the subsidiary's standalone rating. However, PEFINDO can assign one notching up, though rarely, if the subsidiary possesses several strategically important qualities, but is not strong enough to be qualified as strategic.

Moreover, the variety of model of support also brings a complexity to the analysis. A parent company may prefer to show an explicit demonstration of support from the very beginning, while another parent company may choose a more reserved approach, only stepping in when the condition is deemed necessary. Both models have their own positives and negatives, and its applicability may vary based on the business model chosen by the parent for its group companies.

Support more common in FI sector

Considering the nature of the financial institution (FI) sector, where trust plays a very important role for the public - much more than in the corporate/real sector - parent support is more commonly seen than in the corporate sector. In addition, the size and impact of the banking and multifinance industries in respect to the economy leads not only the shareholders of those companies but also the regulators to pay close attention to the companies and their respective industries.

This view is reinforced in the number of entities rated by PEFINDO that benefit from the notching up of parent support. From a total of 58 entities by the end of September 2015, only 17 companies are from the corporate sector, whereas only two of which are considered as core subsidiaries. On the other hand, from the 41 companies in the FI sector, as many as 17 entities are classified as core subsidiaries, either to the government or their respective parent companies. Below is the list of companies classified as core subsidiaries within PEFINDO's portfolio.

No.	Core Subsidiaries	Rating	Industry	Ownership
1	Indosat Tbk	idAAA	Telecommunications	Ooredoo, Pte Ltd, Qatar
2	Perusahaan Listrik Negara (Persero)	idAAA	Electricity	Indonesian Government
3	Adira Dinamika Multi Finance Tbk	idAAA	Consumer finance	Bank Danamon indonesia Tbk
4	PT BCA Finance	idAAA	Consumer finance	Bank Central Asia Tbk
5	Sarana Multigriya Financial (Persero)	idAA+	Secondary mortgages	Indonesian Government
6	Sarana Multi Infrastruktur (Persero)	idAA+	Infrastructure	Indonesian Government
7	Mandiri Tunas Finance	idAA	Consumer finance	Bank Mandiri (Persero) Tbk
8	Bank Mandiri (Persero) Tbk	idAAA	Banking	Indonesian Government
9	Bank Rakyat Indonesia (Persero) Tbk	idAAA	Banking	Indonesian Government
10	Bank Negara Indonesia (Persero) Tbk	idAAA	Banking	Indonesian Government
11	Bank CIMB Niaga Tbk	idAAA	Banking	CIMB Group
12	Bank International Indonesia Tbk	idAAA	Banking	Malayan Banking Berhad
13	Bank OCBC NISP Tbk	idAAA	Banking	Overseas-Chinese Banking Corp Ltd.
14	Bank Sumitomo Indonesia	idAAA	Banking	SMBC Japan
15	Lembaga Pembiayaan Ekspor Indonesia	idAAA	Export credit	Indonesian Government
16	Bank Syariah Mandiri	idAA+	Banking	Bank Mandiri (Persero) Tbk
17	Bank BNI Syariah	idAA+	Banking	Bank Negara Indonesia (Persero) Tbk
18	Bank Tabungan Negara (Persero) Tbk	idAA	Banking	Indonesian Government
19	Bank Rakyat Indonesia Agroniaga Tbk	idAA-	Banking	Bank Rakyat Indonesia (Persero) Tbk

Source: PEFINDO database