The Economic Boundaries of Affiliated-group Firms According to The Credit Rating Agencies' Perspective

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Abstract

Different management literature streams concerning Multinational Corporations (MNCs) have widely recognized the concept of foreign subsidiary autonomy as a focal point of research, while very few contributions have investigated the economic boundaries of affiliated-group entities in evaluating their level of autonomy especially from a practical point of view. This research investigates the behaviours of Credit Rating Agencies (CRAs) experts who face daily analysis of companies and business groups answering the following research question: How do CRAs' experts determine the economic boundaries of the legal entities belonging to a business group? An exploratory multiple case study has been conducted on the basis of multiple data sources, literature findings, two rounds of semi-structured interviews, and publicly available documents. Findings suggest that the business group dimension plays a crucial role in defining the economic boundaries of the legal entities and as an intermediate area of research emerges between the legal entity dimension and the group itself. Furthermore, substantive aspects prevail over the formal ones and multi-business operativity, role of the subsidiaries and group governance result as the main drivers in defining these boundaries.

Keywords: Business Group, Firm Boundaries, Case Study Research, CRAs.

1. INTRODUCTION

Different management literature streams concerning Multinational Corporations (MNCs) have widely recognized the concept of subsidiary autonomy as a focal point of research (see among others, Hedlund, 1980; Bartlett and Ghoshal, 1986; Birkinshaw and Hood, 1998; Paterson and Brock, 2002; Young and Tavares, 2004; Manolopoulos, 2006). The multifaceted notion of subsidiary autonomy (Cavanagh et. al, 2017) has been variously analysed defining different streams of research, such as subsidiary role (White and Poynter, 1984; Jarillo and Martinez, 1990; Birkinshaw and Morrison 1995), and subsidiary initiative and development (Birkinshaw, 1997; Ambos et al., 2010; Raziq et al., 2014; Dörrenbächer and Gammelgaard, 2016).

Business groups may be considered as a set of legally independent companies bounded together with formal and informal ties subjected to a common control or, at least, coordination (Granovetter, 1995; Amatori, 1997; Smångs, 2006). The main conjunction points for the concepts of autonomy and business groups have been related, on the one hand, to the Foreign Owned Subsidiaries (FOS) for which scholars have paid much of their attention (see inter alia, Birkinshaw and Hood, 1998; McDonald et al., 2008; Mudambi et al. 2014) and, on the other hand, to business group governance aspects, such as, equity ties and listed companies (La Porta et al., 1999; Morck et al., 2005) and director interlocks (Mizruchi, 1996; Maman, 1999; Rommens, 2007).

Therefore, the interest has been mainly devoted to the single legal entities even if different studies have highlighted the need to consider internal group relationships to evaluate the autonomy of the subsidiaries (Hedlund, 1981; Garnier, 1982; Gates and Egelhoff, 1986; Jarillo and Martinez, 1990; Birkinshaw and Morrison 1995; Andersson and Forsgren 1996; Taggart and Hood, 1999; Young and Tavares, 2004; Gammelgaard et al., 2012).

However, in the Italian context, very few contributions have been dedicated to the analysis of the effective boundaries (Brouthers and Hennart, 2007) – hence from an economic and not a legal perspective – of the legal entities belonging to a business group in evaluating their autonomy, such as, Cainelli and Iacobucci (2011) and Di Carlo et al. (2016) for what concern the boundaries of the business model within business groups.

Aiming at contributing to the research field on autonomy and business groups, this research investigates a specific practitioner perspective focusing on the behaviours of the Credit Rating Agency (CRA) experts who daily analyse companies and business groups.

The activities of the CRAs are regulated by the Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009. One of their tasks includes the issuing of credit ratings on a professional basis and 'credit rating' means an opinion regarding the creditworthiness of an entity.

The aim of the work is to investigate *how CRAs' experts determine the economic boundaries of the legal entities belonging to a business group*.

An exploratory multiple case study has been conducted to answer the research question. Case studies have been developed on the basis of multiple data sources (Yin, 2018; Stake, 1995), literature findings, two rounds of semi-structured interviews, and publicly available documents (rating methodologies). An interview protocol has been developed and the questionnaire has been defined containing both open-ended and predefined questions.

Mainly evaluating the specificities of the Italian environment, the views of three key informants in top management positions – CEO and directors with a full visibility of and responsibility for the strategy and processes (Eisenhardt and Graebner, 2007) – have been the units of analysis.

Findings suggest that the business group level plays a crucial role in defining the boundaries of the legal entities and as an intermediate area of research emerges between the legal entity and the group itself. Therefore, the boundaries are not polarized only towards the extremes that, in this case, would coincide with a vision completely tied to legislation and consequently to the individual legal entities or, on the contrary and more likely, with a judgment that is totally shifted towards the group level. Furthermore, from a practitioner perspective, substantive aspects prevail over the formal ones and multi-business operativity, role of the subsidiaries and group governance result as the main drivers in defining these boundaries.

The paper is organized as follows. Section two discusses the theoretical background while the CRAs' Italian context is described in section three. Following this, the research methodology is summarized in section four. Section five presents the research results. Finally, conclusions, limits and implications for future research are provided in section six.

2. THEORETICAL BACKGROUND

Even though management literature concerning MNCs has widely recognized the concept of subsidiary autonomy as a focal point of research (see among others, Hedlund, 1980; Bartlett and Ghoshal, 1986; Birkinshaw and Hood, 1998; Paterson and Brock, 2002; Young and Tavares, 2004; Manolopoulos, 2006), most of the contributions have been devoted to single legal entities, mainly, Foreign Owned Subsidiaries (FOS) under the subsidiary role (White and Poynter, 1984; Jarillo and Martinez, 1990; Birkinshaw and Morrison 1995), and subsidiary initiative and development (Birkinshaw, 1997; Ambos et al., 2010; Raziq et al., 2014; Dörrenbächer and Gammelgaard, 2016) literature streams. Young and Tavares (2004) in their seminal work proposed a broader definition of autonomy: "the constrained freedom or independence available to or acquired by a subsidiary, which enables it to take certain decisions on its own behalf" (Young and Tavares 2004: 228).

Relationships between the concept of autonomy and research on business groups have been mainly related to business group governance aspects, such as, equity ties and listed companies (La Porta et al., 1999; Morck et al., 2005) and director interlocks (Mizruchi, 1996; Maman, 1999; Rommens, 2007) but, for this contribution, several studies on MNCs have been also considered in order to take hints on internal group links aspects useful to evaluate the autonomy of the subsidiaries (Hedlund, 1981; Garnier, 1982; Gates and Egelhoff, 1986; Jarillo and Martinez, 1990; Birkinshaw and Morrison 1995; Andersson and Forsgren 1996; Taggart and Hood, 1999; Young and Tavares, 2004; Gammelgaard et al., 2012).

According to Smångs (2006), scholars have interpreted the concept of business groups mainly under two perspectives and, for the present study, both the literature streams have been considered in defining the interview protocol to answer the research question. Generally, under a European angle view, business groups may be considered as a set of legally independent companies bounded together with formal and informal ties subjected to a unified control or, at least, coordination (Granovetter, 1995; Amatori, 1997). The straightforward aspect of this definition is that firms are linked together through chains of ownership relationships (Smångs, 2006). On the other side, studies on emerging markets have focused on the concept of diversified business groups (Ghemawat and Khanna, 1998; Guillén, 2000; Khanna and Yafeh, 2007). In that case, definitions of business groups contain an additional reference to the multi-business aspect, such as "multiple strategically-unrelated activities" (Cuervo-Cazurra, 2006) or "number of technologically or product-wise unrelated fields" (Colli and Colpan, 2016). When referring to advanced countries, diversified business groups may also be labelled as 'conglomerates' a form that emerged in the 1950s in US mainly for sectors such as public utilities, transportation, textiles, mining and food (Amsden and Hikino, 1994).

According to the definitions that consider a business group as a collection of firms bounded together, Granovetter (1995) has suggested to exclude from this broad definition both short-term alliances and situations in which firms are legally consolidated into a single entity. Therefore, "included under the heading of 'business groups' are sets of firms that are integrated neither completely nor barely at all" (Granovetter, 1995: 96) and the result is that "business groups face a constant tension between the desire of individual firms within the group for autonomy and the group's need to control the actions of different firms" (Maman, 1999: 324).

Aiming at contributing to the research field on autonomy and business groups, this research explores that 'intermediate' area of investigation within business groups that emerges from the above-mentioned contributions. However, very few contributions have been followed this stream of research dedicated to the analysis of the real boundaries of the legal entities belonging to a business group in evaluating their autonomy. According to this view, the two extremes correspond from one side to a vision completely based on legislation and, consequently, to individual legal entities and, from the other side, to a business group perspective.

Some interesting contributions by Cainelli and Iacobucci (2011) and Di Carlo et al. (2016) have been considered. According to the former, when a company is part of a business group "it is the business group rather than the individual legal unit that is most suited to a study of the behaviour and organization of firms; that is, the business group rather than the individual legal units that compose it is the most appropriate unit to delimit the firm boundary" (Cainelli and Iacobucci, 2011: 1551). In practice, according to these findings, the most appropriate unit of analysis should correspond to the consolidated level ("the financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity", IFRS 10) for which the legal entities belonging to the same business group are presented as a single economic entity. Therefore, consolidation concept and available data and information required by the international accounting standard IFRS 10 could be particularly useful to investigate the boundaries for affiliated-group companies.

The study of Di Carlo et al. (2016), on the boundaries of the business model within business groups, shows that "the consolidated financial statements (or sub-consolidated financial statements) may express the results as: a sub-economic entity; an economic entity in its own right; or more economic entities" (Di Carlo et al. 2016: 358). In addition, synergies within legal entities disclosed in the same operating segment have been considered. This latter conclusion allows us to consider the International Financial Reporting Standard n. 8 (IFRS 8) which could provide some interesting insights because it considers an intermediate level between the single legal entity and the business group. Indeed, an operating segment is "a component of an entity that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity); whose operating results are reviewed regularly by the entity's chief operating decision maker; for which discrete financial information is available" (IFRS 8.2).

For this study, consolidated statements and business segments have represented two of the main topics identified in the questionnaire for what concerns the accounting side features. The presence of more than one consolidated financial statements within the same business group or more operating segments has been considered as a *proxy* to identify and investigate diversified business groups (Ghemawat and Khanna, 1998; Cuervo-Cazurra, 2006; Colli and Colpan, 2016)
Furthermore, Intra-group flows are another crucial accounting aspect that has received considerable consideration in the literature. Indeed, they have been used by different scholars as one of the main elements able to explain the subsidiary autonomy within MNCs (among others, Ambroselli, 2021; Ambroselli, 2022). Operationally, they can be considered as a subset of Related Party Transactions (RPTs) defined as "a transfer of resources, services, or obligations between related parties, regardless of whether a price is charged" (IAS 24:9).

Early research on Headquarters-Subsidiary Relationships showed as high level of intra-group transfers and low subsidiaries' autonomy were related (Hedlund, 1981) or, in other words, as the greater the intracompany purchases by a subsidiary, the more decision-making for the subsidiary would be centralized (Garnier, 1982; Gates and Egelhoff, 1986). The authors of this stream of research generally use in their quantitative analyses the flows of resources between the parent and the subsidiaries, except for Taggart and Hood (1999) who have included in their model the concept of sister subsidiaries.

Under the subsidiary role literature stream, a wider concept of intra-group relationships emerged in the years later according to the contributions of Jarillo and Martinez (1990) who have included in their analysis the flows of inputs from other subsidiaries and Birkinshaw and Morrison (1995) who have shown as high strategic autonomy of subsidiaries was associated with low inter-affiliate purchases. Kobrin (1991) focused on the evaluation of the degree of integration of a MNC including in the analysis intrafirm flows distinguished in 'affiliate to affiliate', 'affiliate to parent' and 'parent to affiliate'. Finally, according to a network approach to MNCs, intrafirm trade has been generally considered as one of the most relevant dimensions of corporate embeddedness (Andersson and Forsgren, 1996) while Young and Tavares (2004) found a negative correlation between corporate embeddedness, proxied by intra-group trade, and autonomy.

Pursuing in collecting management literature suggestions to define the main topics to afford during the interviews, some business group governance themes have emerged such as the presence of listed firms within the group (Morck et al, 2005; Almeida and Wolfenzon, 2006; Morck, 2009) and the boards composition aspect. Concerning the latter, the phenomenon of Intra-group Interlocks (IgI) is particularly interesting. As an interlocking occurs where an individual seats in two or more boards of directors of different companies (Riner, 1981; Mizruchi, 1996), IgI exist when the same director is present in two or more affiliated-group companies. This tool for control and coordination within business groups has been widely used in the context of family business groups especially when the companies are located at a higher hierarchical group level (Rommens et al, 2007).

3. CREDIT RATING AGENCIES (CRAs): THE CONTEXT

The activities of the CRAs are regulated by the Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009. The competent authority to notify the decision on the registration, refusal of registration or the withdrawal of registration of a CRA is the European Securities and Market Authority (ESMA). Main definitions are in article 3 of the Regulation:

- 'credit rating' means an opinion regarding the creditworthiness of an entity;
- 'credit rating agency' means a legal person whose occupation includes the issuing of credit ratings on a professional basis;
- 'rating analyst' means a person who performs analytical functions that are necessary for the issuing of a credit rating;
- 'rated entity' means a legal person whose creditworthiness is explicitly or implicitly rated in the credit rating, whether or not it has solicited that credit rating and whether or not it has provided information for that credit rating.

Therefore, the credit rating is a judgement on a company's ability to pay its debts or not. This judgement is expressed by an external and independent entity, the credit rating agency, that assesses the ability of the company to generate the resources needed to meet its commitments to its creditors. This opinion shall be reviewed periodically. The rating is an opinion on the creditworthiness of a company; therefore, it assesses the capability of the company to generate sufficient cash flows for a prompt debt repayment in a given time horizon. In terms of information available for rating, the distinction between 'unsolicited rating' and 'solicited rating' is particularly important. The first is an evaluation issued upon request of a third party or at CRAs' own initiative and happens when the CRA operates as an ECAI (External Credit Assessment Institution). The latter is an evaluation issued upon request of the rated entity or by a third party acting on behalf of the rated entity (the related third party) because, for example, has an interest in showing that it is in good health. Related third party, defined in article 3 of the Regulation, means the sponsor, servicer or any other party that interacts with the credit rating agency on behalf of the rated entity, including any person directly or indirectly linked to it by control.

In 2017, in Italy about 15 agencies (comprising the big 3 US companies Moody's, Fitch Ratings, Standard & Poor's) were active. To evaluate the specificities of the Italian environment, the three Italian rating Agencies currently operating were considered. In particular, the views of three key informants in top management positions, CEO and directors with full visibility of and responsibility for the strategy and processes (Eisenhardt and Graebner, 2007), have been the units of analysis.

4. METHODS

Case study research is well suited to investigating complexity (Eisenhardt, 1989, Yin, 2018) and an exploratory multiple case study has been conducted to answer the research question. A multiple case study allows the researcher to examine differences within and between cases (Yin, 2018).

The remaining part of this section includes a description of the steps of the research: define and design, data collection, and analysis.

4.1 Research Design and Define

The initial stage includes the selection of the cases, the design of the data collection protocol and the preliminary contacts with the credit rating experts.

The selected rating agencies have some common characteristics as they are the only Italian companies active in this sector. Thus, they can provide literal replication (Yin, 2018). In fact, "the goal of theoretical sampling is to choose cases which are likely to replicate or extend the emergent theory" (Eisenhardt, 1989, p. 537). Having multiple cases allows the researcher to increase the robustness of a finding by replicating it across cases (Piekkari et al., 2009).

The fictional names used to maintain anonymity are the following, A, B, C.

To get in touch with Rating Agencies A and C, we made research on the web looking for persons responsible of the rating activities inside the companies. In that way, we had the possibility to contact the Director of the corporate ratings sector of CRA-A and the responsible of the team of rating analysts for CRA-C. For CRA-B, we had the opportunity to contact the CEO of the company directly.

For all the cases, the first approach was by email. We presented the research project in a very general way and explained the specific reasons why we started to contact CRAs. In the last part of the email, we asked for cooperation assuring that for the purposes of the research what we needed, from a methodological point of view, were qualitative data based on a short questionnaire. Immediate reactions were very encouraging:

"The specific issue of the impact of belonging to a business group on the rating certainly provides good insights" (CRA-A).
"The topic is relevant and there is certainly an intermediate research area between the single legal entities and the business group" (CRA-C).

Furthermore, the CEO of company B agreed to cooperate and provide us with the name of the person in charge of rating activities, whom we contacted subsequently to request an interview.

An interview protocol was developed (see Appendix 1) into two parts: a first and quick round of questions useful to obtain the informant's opinion on the feasibility of the research and the validity of the research question; a second in-depth round of interviews useful to investigate the specific elements that the CRAs experts consider to delimit the boundaries of the companies under assessment. Based on literature findings, we identified a set of topics and designed a semi-structured questionnaire to understand whether or not rating operators consider those variables rating purposes. Open-ended questions were designed to encourage a broad conversation (O'Dwyer, 2002). In defining the questionnaire, also international accounting standards on consolidated financial statements (IFRS 10), operating segments (IFRS 8) and Related Party Transactions (RPTs) (IAS 24) have been considered.

Interview protocol and questionnaires were evaluated by 5 academics to better fine-tune the tool adopted, a qualitative multiple research case, and the purpose of the research. The protocol was considered correct and adequate, and the multiple case study was considered appropriate to answer the research question. Having both open and predefined and structured questions allows us to grasp the central aspects of the work. Moreover, the first round of interviews helped to better understand the terminology used to more precisely define the questions of the second round. To have elements of comparison between the different cases, the interviews were carried out in a homogeneous way both in terms of structure and individual questions. At the same time, the open questions allowed to maintain a certain degree of flexibility in the interview, useful to highlight and subsequently compare the different approaches of the rating agencies in a more orderly way.

At the end of this assessment, the questionnaire was defined. The first part of the questionnaire contains a set of open-ended questions on accounting and ownership aspects, while the second part some questions useful to obtain quick reactions on methodologies and practical situations.

4.2 Data Collection

Case studies have been developed on the basis of multiple data sources (Yin, 2018; Stake, 1995), literature findings, two rounds of semi-structured interviews, and publicly available documents (rating methodologies).

Interviews were the main source of information used for this research and they were carried out in two rounds. The first round of interviews was carried out by phone calls while the second via face-to-face meetings. Field notes were taken during the first-round while in the second, interviews were recorded. Interviews were carried out in Italian and transcribed by us to facilitate the subsequent data analysis step mainly based on coding (Miles and Huberman, 1994; Patton, 1990; Saldaña, 2016). The transcriptions in Italian were used for draft reports and once the companies validated the case reports, they were translated into English (Cerruti et al, 2016). Data triangulation was obtained by using multiple sources of data or evidence, interviews and documents, and multiple theoretical views on the datasets (Patton, 1990; Denzin, 2017).

According to that strategy, data were collected. Details of the interviews are reported in Appendix 2 including the role of the key informants, number of meetings and their total duration.

Phone calls of the first wave of interviews had an average time of 25 minutes. As anticipated in the previous section, the interviews had the same pattern with a first part dedicated to the presentation of the project, the researcher and the structures involved in the research, and a second focused on the macro themes of the questionnaire. A selection of references to the international literature were made to immediately assess their effective anchorage in professional practice. Terminology, hints and suggestions of the experts were carefully evaluated to define the final version of the questionnaire. Furthermore, clarifications were requested on the meaning of rating and the context of rating agencies.

The second wave of interviews was conducted face-to-face. The meetings had an average time of more than 62 minutes and in all the cases most of the time was spent on open-ended questions.

The interview protocol envisaged an initial discussion on two macro topics: accounting and ownership side features. For the former, sub-topics were consolidated accounts and multi-business groups, business segments and RPTs. For the latter, control rights and cash flow rights, board's composition and listed companies. For both topics, the tendency of the respondents was to describe their approach in general. On some occasions, intervention was necessary to ensure a response to all planned research topics and to follow the predefined order. However, in some cases it was necessary to move from one topic to another to allow the experts to fully describe their vision. From an operational point of view, always using the predefined questionnaire as a guide, it was possible to obtain a response covering all topics defined in the research protocol.

The last part of the questionnaire was dedicated to obtaining quick reactions on methodology and practical situations. The time devoted to these questions was deliberately shortened. These answers provided a twofold result. On the one hand, they represented a summary of the main elements indicated by the respondents; on the other hand, they also were an excellent tool in assessing the quality of the subsequent coding phase.

4.3 Data Analysis

Data analysis was carried out in two major steps: a within-case analysis focused on each case separately, and a cross-case analysis looked for similar constructs and themes in the cases (Eisenhardt 1989; Yin 2018). Each individual case study was enriched with data from the company public available methodologies. Indeed, according to Art. 8 of the Regulation (EC) No 1060/2009 "a credit rating agency shall disclose to the public the methodologies, models and key rating assumptions it uses in its credit rating activities". In the first step, individual profiles of the cases have been developed and analysed. Having achieved more familiarity with each single case, a cross-case analysis was conducted, looking for similarities and differences across the cases studied (Miles and Huberman 1994; Eisenhardt and Graebner 2007).

Analysis of interview data used a coding based on the main topics identified in the questionnaire: business groups, consolidated accounts, multiple activities, business segments, commercial and financial flows, boards' composition, and governance factors. According to Saldaña (2016), "a code in qualitative inquiry is most often a word or short phrase that symbolically assigns a summative, salient, essence-capturing, and/or evocative attribute for a portion of language-based or visual data" (Saldaña, 2016: p. 4). For this research, a solo manual coding activity on hard-copy printouts was carried out first. After that, patterns were summarized in tables to identify the main aspects useful to answer the research question.

Concerning the criteria to judge the quality of case study research (Yin, 2018) the main aspects are presented in Table 1.

Quality criteria	Actions
Construct validity	Guaranteed by using multiple sources of evidence (Eisenhardt, 1989; Stake, 1995; Yin, 2018) including literature review. Key informants interviewed were in perfect positions – director or responsible for rating activities – having full visibility of and responsibility for the processes.
Internal validity	Guaranteed by selecting cases studies from a single context. Pattern matching (Yin, 2018), coding (among others, Saldaña, 2016), and triangulation (among others, Denzin, 2017) were used for data analysis.
External validity	Limited by the fact that all the case studies are taken from a single context even though a multiple case guarantees a replication logic (Yin, 2018). On the other hands, robust findings were found for the CRAs' context.
Reliability	Guaranteed by the transparency of the process (Yin, 2018): a stable and consistent study process was guaranteed, and case study and interview protocols were defined and guided the data collection. Respondents were carefully selected, and companies validated the reports.

Source: author's elaboration based on Yin (2018)

TABLE 1: Quality criteria for case study research.

5. FINDINGS

According to the specific regulation presented in section 3, the legal entity is the subject to be evaluated and named as 'rated entity'. However, under the same legislation it is clearly required that the results cannot be a pure calculation score, but the analysts' intervention is required. For this reason, the rating system is composed by two distinct areas of analysis and methodologies: the first based on quantitative data and statistical models while the second focused on qualitative information. Therefore, each CRA creates its own policy for rating by combining a set of financial and economic ratios with further considerations made by the analysts. The result is that ratings may diverge from CRA to CRA, not only due to the use of different models but also considering and weighting differently other aspects than quantitative ratios. For the credit ratings requested by the rated company (solicited rating), both quantitative and qualitative aspects are enriched with additional data and informative material gathered by the analysts directly from the company also through interviews to the top management.

The following section is devoted to present the main aspects derived from data analysis and useful to answer the research question.

5.1 Going Further the Single Legal Entity

In their daily activity, the interviewees, as well as the other CRAs experts of the agencies for which they work for, assign ratings considering data, information and characteristics that go beyond the single legal entity. Furthermore, data and information of other companies belonging to the group and operating abroad are considered both when the holding company is abroad and when the subsidiary is abroad. As well described by the following words, the substantive aspects must prevail over the formal ones:

"The premise is that the rating, regardless of the individual legal entity to be evaluated, must capture what is, from a substantial point of view (economic-financial point of view) the single entity to consider from the credit risk point of view. Therefore, the legal limits of the entity do not necessarily correspond to that which is the substantial perimeter identified for rating purposes" (CRA-A).

According to the view of another expert, the analysis of the business model represents the fundamental aspect, and this means necessarily to go beyond the single legal entity.

In practice, a rating expert may be faced with the following situations: i) a stand-alone company for which the rating evaluation concerns only one legal entity; ii) a consolidated group with activities highly integrated for which the rating evaluation concerns the entire group; iii) a 'grey area' for which the analysis does not lead to the previous results and leaves a certain margin of discretion to the analyst.

Within this 'grey area' different models of interaction among entities belonging to the same group can be found, strong, medium and weak relationships. The analysis of these situations is highly dependent on the qualitative aspects and heavily influenced by the analyst's judgment.

"The rating goes one step further: as requested by ESMA, the rating must have the assessment of an analyst who analyses all those qualitative characteristics that involve the company and that actually define the economic context in which it operates. We move from a quantitative model to a model where the analyst intervenes, which we can define as qualitative" (CRA-B).

5.2 Business groups as the starting point for the analysis

The initial step of the analysis is undoubtedly the evaluation of the 'perimeter of the group'. A clear and effective formalization such as an organization chart is defined as a matter of priority. The purpose is to obtain a complete picture of the entities to consider as the starting point to detect the relationships and evaluate the embeddedness within the group perspective.

Relationships with other legal entities within the group are considered extensively, considering when necessary other related parties and not only the affiliates.

"The aim is to analyse the group with all the synergies present in it. For each individual entity this means considering the synergies that exist among them and with the parent company. Relationships can be of different types: commercial, financial or both" (CRA-C).

Some differences of treatment have been found concerning the possibility to assign ratings at group level when the activities of the legal entities belonging to the business group are all coordinated as a single economic entity. For two CRAs, the answer has been positive: especially for small and medium size business groups, CRAs tend to treat them as single economic entities because none of them (legal entities) have the complete set of characteristics needed to be autonomously rated. For the remaining CRA, according to the EU regulation, the subject of the rating is always a single legal entity but notwithstanding this formal aspect also its methodology considers the complete set of group relationships.

5.3 Consolidated financial statements as the preferred accounting document

"When analysing the legal entity, the analysis of the consolidated financial statements is the predominant part of our activity and is always to be preferred to the separated financial statements" (CRA-B).

The presence of consolidated financial statements allows to identify those entities that should represent, at least in theory, a single entity from an economic-financial point of view. However, alongside the mere existence of consolidated financial statements other elements (see the remainders of this section) must be considered to determine how much the companies belonging to a group actually represent a single entity.

"The result could lead to a situation in which it would make sense to consider a group rating (to be extended to all the entities of the group, if necessary) but also to the diametrically opposed case in which, regardless of its presence in the consolidated financial statements, the individual

entity has such peculiarities that it can be considered, from the credit point of view, autonomous and therefore to be assessed with a logic defined by us as stand-alone" (CRA-A).

The analysis of consolidated financial statements is the first step of all CRAs methodologies. Having consolidated financial statements is easier to see and evaluate internal group dynamics.

"The analysis of the consolidated financial statements is fundamental because it allows us to understand the performance of the 'soggetto economico' regardless of the legal barriers among different subsidiaries" (CRA-C).

Due to legal requirements, some groups do not produce the consolidated financial statements but even in these cases all the financial statements of the subsidiaries and, in general, of all the legal entities belonging to the group are analysed in order to remove intragroup transactions and trying in some way to reconstruct an aggregate to have a general picture at group level.

"In cases where consolidated financial statements are not prepared (under legal requirements), this does not mean that the entities should not be assessed as a whole" (CRA-A).

Even though more difficult, there could be some cases of groups that are sufficiently articulated also below the thresholds to draw up consolidated financial statements.

5.4 Multiple activities: a multifaceted aspect for different levels

When talking about multi-activity aspect, multiple levels of analysis have emerged. Firstly, sub-consolidated accounts may be used, in some cases, to clearly separate different businesses within a conglomerate. These different businesses may also correspond to different sectors or industries.

"As far as multi-business groups are concerned, we hardly consider the highest consolidated financial statements of a company that includes as many different sectors as our starting point. We use sub-consolidated accounts" (CRA-B).

The logic is to avoid too dispersive analysis always preferring to consider specific sectors of activity. In these cases, considering the whole group may not be useful because the risk is losing details concerning the sectors.

The second level of analysis concerns the single legal entities. In some cases, entities may carry out more activities and the analysts must determine the predominant one while in other situations is crucial to define the actual activity carried out by the company. In other words, regarding multi-sector groups, the purpose is to understand whether companies belonging to different sectors are relevant or not within the group and whether they bring value.

"The aim is to understand the role that the units play within the group and all that concerns the economic and financial aspects of the business" (CRA-C).

This practitioner perspective is in line with the well-known subsidiary role literature stream for which scholars (see among others, Bartlett and Ghoshal, 1986; Jarillo and Martinez, 1990; Birkinshaw and Morrison 1995) produced several studies starting from the seminal contribution of White and Poynter (1984).

This kind of analysis brings the analysts to define and fully understand the core businesses of the group and, as a consequence, to detect the entities with a strategic role within the group. Generally, the situation consists of a set of manufacturing, trading and services companies, both national and foreign subsidiaries, focused on the core business and other non-strategic units related only to diversification aspects. In the former case the evaluation is based on an aggregation of legal units carrying out different activities because some units could be fully or mainly auxiliary to others. In the latter case, companies less close to the core business could be evaluated according to a stand-alone perspective.

The third perspective concerning the multi-business operativity of a group is related to the operating segments (IFRS 8). When different segments refer to different set of aggregated legal entities for which none of them are in common, operating segments are analysed in detail to identify the individual companies that contribute the most to create value for the business. On the contrary, when a legal entity contributes to more operating segments, even though very different, the conclusion of the analysts is that the legal unit is one and deconsolidate the segments is not possible. Nevertheless, for CRAs' experts considering the operating segments is not very usual with some exceptions mainly for multi-utility companies while understanding the role of the subsidiaries within the business group is a necessary step to follow during the evaluation process for each analyst.

5.5 Internal flows as a proxy of the group embeddedness

The rating methodologies of the CRAs take great account of related party transactions (IAS 24) because economic and financial connections between the rated entity and its related companies, mainly parents and subsidiaries, can affect a company's credit profile.

"It is important for us to understand the level of relationships, both commercial and financial, among units within the business group and how these relationships are governed" (CRA-C).

The issue is very relevant to understand both the degree of free circulation of financial flows and the commercial relationships able also to define the actual activities carried out by the companies and their role within the group.

In this step of the process, analysts go back and consider the data of the individual legal entities because, as we have seen above, the starting point is the consolidated financial statements. According to the consolidation perspective, the financial structure is disclosed for the group seen as a whole and the internal flows are deleted. In order to understand the level of RPTs, the complex network of relationships is considered following a customer/supplier logic for the commercial flows and looking for the presence of an intercompany cash pooling mechanisms to evaluate the financial aspects. As seen in section 2, scholars have adequately used in their studies the commercial flows.

5.6 Group governance as the overlying aspect

Considering the group level does not mean only to define its structure in terms of legal entities and control chain structure but implies the necessity to evaluate the governance at group level as an overall concept to consider. In particular, three main elements must be considered in understanding the way a business group is governed: ownership, management and control aspects. The way these three elements have been set up may determine differences among groups policies. For solicited ratings the analysts have the possibility to consider additional official data from the companies such as business plans, interim financial statements, consolidation reconciliation schedules, audit reports, in order to fully define the policies adopted by the group. This kind of evaluation allows the possibility to theoretically build blocks of firms that should be analysed more autonomously within the business group positioning between the single legal entities and the group itself. Generally, this situation occurs when the group leader is not very active within the group, for example, when a foreign parent company leaves high autonomy to the subsidiaries. A situation that can occur, for example, when all the core operating activities are carried out in the host country through its subsidiaries. An analyst is fully aware that the parent company can intervene at any time but, in these cases, this possibility marginally affects the evaluation.

Therefore, group policies may determine other situations in which intermediate aggregations of legal entities within the group are the proper areas to consider for the evaluation alongside those related to multi-business groups and diversification aspects. In these cases, commercial or financial relations are low because the group policy leaves the structures autonomous. Rating press releases contain this information but in a marginal way.

Concerning the Italian context, different kind of ownership such as family groups, foreign-owned subsidiaries (FOS) and State-Owned Enterprises (SOEs), have an impact on the assessment of the presence of more autonomous parts within business groups. Concerning the SOEs, it is important to understand how much the State shareholder actually influences an entity to the point of being considered part of the public administration itself. For all types of ownership, when assessing the company's corporate governance practices, CRAs focuses on aspects such as the independence of the board of directors. Basic idea is that the more members are in common, the more integrated the companies are. Analysing the composition of the board of directors is a step followed by all the CRAs and the results may influence the rating. As shown also by scholars (Boyd and Hoskisson, 2010; Fattobene et al., 2018), the intra-group interlocks phenomenon is mainly present in family groups.

The group governance concept is so pervasive to also influence the evaluation of the listed companies within the group. Not necessarily they are considered as a stand-alone:

"You have to consider the substance of the situation: although the underlying company is listed, there are cases where the internal links are relatively strong" (CRA-A).

A fortiori, due to their importance for the entire system, listed companies are analysed even more carefully considering their relationships within the group. The aim is to understand whether the performance of the listed company is influenced by the performance of the subsidiaries. Furthermore, as seen above, for an analyst is crucial to determine the role of the entities to understand which of them are considered as strategic in terms of turnover, RPTs and shareholdings.

"We identify the most important companies to understand not only if their performance is consistent with that resulting from consolidated data, but also the influence it has on the consolidation itself" (CRA-B).

Finally, all the analysts consider the control rights for the entire control chain. When all other conditions being equal, a wholly owned subsidiary is considered more integrated compared to a majority control. In this latter case, minority shareholders could be considered in the analysis especially if they are represented by a board member.

5.7 Closing the Process: The Soft Elements

Even though not very usual, there could be situations in which other elements defined as 'soft' may have an impact for the attribution of the rating.

A set of common factors such as the same headquarters and an overlapping name between the parent and the subsidiaries may have some influence on the reputational aspect reinforcing the idea of considering an aggregation of legal entities. The same consideration is valid when the group is more embedded in a specific geographical area. In these cases, even if no financial and commercial links between the legal entities are made explicit, a sort of uniqueness of the group could be considered.

Other two aspects with a potential impact on the process are the Country of the foreign subsidiary and the sector. In some cases, the parent possibility to influence the activities of the subsidiaries in some host Countries could be limited. Furthermore, the analysts consider the Country also in terms of risks for ratings. This is a well-known aspect evaluated by scholars under the subsidiary autonomy literature stream (De Jong and Dut, 2010; Miozzo and Yamin, 2012).

The sectors in which the group are involved may also play a role in determining the boundaries within the business group. As far as Italy is concerned, regulated sectors such as utilities require the analysis to be supplemented with indicators and parameters more relevant to the sector.

6. DISCUSSION AND CONCLUSIONS

Aiming at contributing to the research field on autonomy within business groups, this research investigates a specific practitioner perspective focusing on the behaviours of the Credit Rating Agency (CRA) experts who daily analyse companies and business groups, in order to understand how these practitioners determine the boundaries of the legal entities belonging to a business group. An exploratory multiple case study based on semi-structured interviews has been conducted to answer the research question; a method that as far as concerns the Journal of Business Research and Management, has been recently used for several and variegated works (see, among others, Maher and Czarczyńska, 2022; Biancone et al. 2020) related to Organization and Management Theory and International Management themes (Cristofaro et al., 2021).

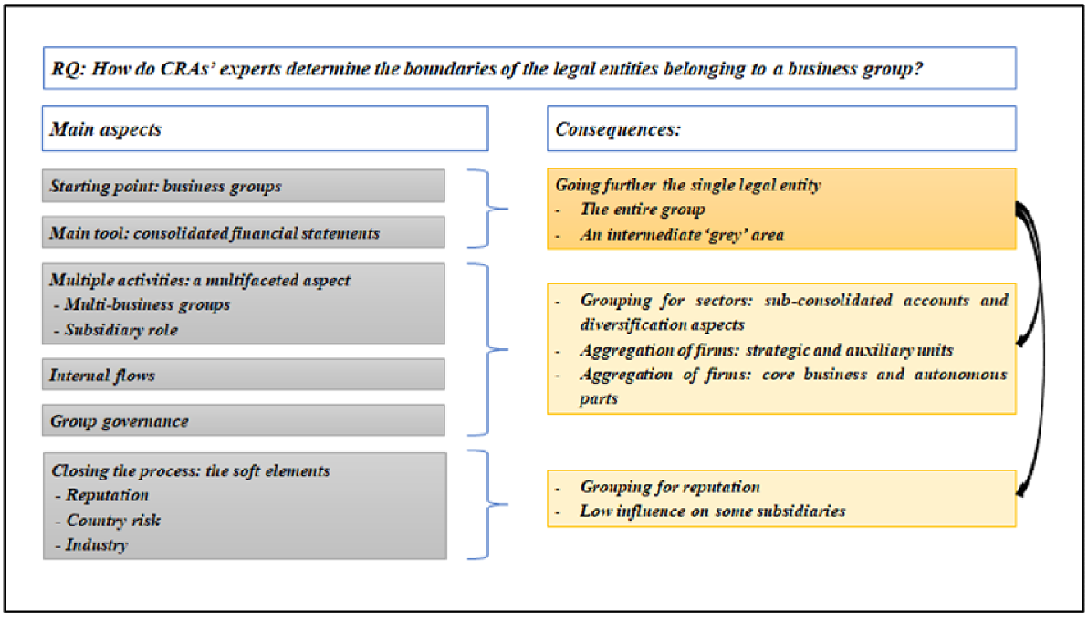
Findings suggest that in determining the economic boundaries of an affiliated-group firm, an intermediate area of investigation within business groups exists. As shown in figure 1, although the subject of the rating is a single legal entity, the experts go further considering both the entire group and intermediate 'grey' areas generated by different reasons. Consequently, the boundaries are not polarized only towards the extremes that, in this case, would coincide with a vision completely tied to legislation and consequently to the individual legal entity or, on the contrary and more likely, with a judgment that is totally shifted towards the group level.

The business group dimension plays a crucial role in defining the economic boundaries of the legal entities and consolidated financial statements represent the predominant accounting document for the analysis. When sub-consolidated accounts exist and mainly refer to different sectors, they constitute the starting point to determine the areas of investigation. Therefore, legal entities could be aggregated for sector as, from a practitioner perspective, substantive aspects prevail over the formal ones.

Furthermore, legal entities within business groups could form a sub-aggregation of entities according to their specific relationships in terms of activities carried out and internal flows. That could happen when an entity is considered as strategic while others play only an auxiliary role with regard to it or when, in addition to its core business, the group has other more autonomous and separated activities carried out by other entities. In these cases, the role of the subsidiaries and group governance aspects result as the main drivers in defining these boundaries.

Finally, other variegated elements could determine a different grouping useful for the evaluation. In some situations, the parent could have low influence on some foreign subsidiaries due to the local environment of the host countries or industry regulations. In other cases, some common aspects such as overlapping headquarters and name, could determine an aggregation of legal entities useful to obtain the proper picture. In terms of industry, upstream-downstream integrated activities should support the aggregation of legal entities for the assessment even up to comprising the entire group especially for small and medium size groups. In this perspective, manufacturing activities should be more sensible to the phenomenon but in some cases a siilar logic could also be found in terms of services offered. Moreover, the common example for all the interviewees has been the multi-utilities sector where also legislation aspects affect.

Even though basic elements of literature findings mainly concerning parent-subsidiary relationships, Intra-group Interlocks (IgI) and chain of listed companies within pyramidal groups are known, these aspects are not explicitly recognizable in the rating press releases. As seen in the previous section, these elements are indeed considered but included in the wider perspective of the group governance and, accordingly, the analysts use all the elements at their disposal to evaluate ownership, management and control aspects. Business profiles derive from both financial and economic aspects and the internal flows are referred to the entire group and to other related parties, when needed. Two aspects feed the business profile development: legal such as, ownership, control and National legislation features, and economic.



Source: author's elaboration based on Yin (2018

FIGURE 1: An intermediate area of investigation within business groups.

This research has several implications. As far as theory is concerned, this study highlights how some of the results produced in the research stream dedicated to the identification and analysis of the determinants of the subsidiary autonomy need to be reviewed in the light of the possibility that an intermediate area formed by a subset of units within the business group can be seen as the most appropriate unit of analysis to consider. According to the need of both scholars and practitioners to investigate on comparable units - irrespective of the number of legal entities they are formed by - the necessity to precisely assess the boundaries of a company within a business group is further confirmed by the results of this study.

The consequences of the proper identification of the unit of analysis are relevant for different types of research such as those on the performance or size of the companies, their growth strategies or concerning classification aspects in terms of industry and functions within the global activities of an MNC. According to these considerations, research findings could also provide some suggestions for the regulators: policies should consider from case to case the most appropriate unit of analysis in relation to the different aims of the actions.

As seen in section 3, being a rating agency within the EU means responding to a code of conduct of policies and procedures defined by Regulation (EC) No 1060/2009. By adopting a common foundation, the hope of the regulators was to foster the development of similar practices among rating agencies. The research showed as in the Italian context, practices are guided by a common logic although quantitative models and especially the assessment of qualitative aspects could differ from CRA to CRA. Furthermore, results showed that governance aspect and soft elements may also have an impact on sub-aggregation of firms within the business groups for rating purposes. Therefore, further insights into all aspects and consequences highlighted to answer the research question (Figure 1) might be of interest for ESMA and national authorities.

Although the study adopted a set of actions to fulfil the quality criteria (Yin, 2018), there are certain limitations to this study and hence its findings.

Firstly, the study has been conducted only for the Italian context. Even though the situation across EU should be quite homogeneous due to the adherence to a common Regulation and the presence of a common Authority (ESMA), different characteristics of the corporate governance in other Countries may have an impact on the results. Without considering the fiscal aspect, the basic logic should be identical and based on the economic and financial results originated by the business strategies but specific national laws for some industries may determine some differences. Future research based on comparative studies across different Countries could be particularly useful to enhance the findings of this study. Possible lines of research could focus on some specific business groups according to different kind of ownership or sectors. For State-Owned Enterprises (SOEs) could be interesting to evaluate the actual role of the different public administrations in terms of governance especially when national legislations exist and have an influence for the composition of the boards. In general, governance aspects seem to be the most promising to develop further studies. In this regard, it might be useful to compare the results of this research with the perspectives of professionals working in countries where the two-tier system is the main form of governance. Finally, in terms of sectors, comparisons should privilege countries with a comparable industry structure.

Secondly, the study allows to find robust findings for the CRAs' context obtaining a way to analytically compare theoretical results and business practices. However, investigating on other practitioner perspectives could improve the knowledge on different approaches to examine business groups.

Finally, concerning the findings it is useful to underline that CRAs' experts for solicited ratings have a privileged position with respect to scholars because they are equipped with a complete informative set retrieved both from official sources and from the rated company. This additional information influences both qualitative and quantitative aspects. For the former, it allows the analysts to get information on group governance achievable only through this direct relationship with the company while, for the latter, additional ratios based on internal accounting documents can be added in the model. While taking these limits into account, an empirical evaluation of some of the findings of this study could represent another potential area for future research.

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APPENDIX 1 – Interview Protocol

First round interviews
Questions on the basic ideas of the research and the informant's opinion on facts:
- Context in which the rating agencies operate
- What is meant by rating
- Evaluation of the business groups membership role

Quick reaction on some specific features:
- Feasibility of the research
- Business theories

Second round interviews
Questions on the accounting side features:
- Consolidated accounts and multi-business groups (conglomerates)
- Business segments
- Related party transactions:
  - Economic flows
  - Financial flows

Questions on the ownership side features:
- Control rights and Cash flow rights
- Board's composition
- Listed companies

Quick reactions on methodology and practical situations:
- Do you generally assign ratings taking into account data, information and characteristics that go beyond the single legal entity? If yes, do you think is possible to answer in the same way for the agency in which you work?
- In view of the Italian context, is it common to assign ratings at group level considering that the activities of the legal entities belonging to the business group are all coordinated as a single economic entity?
- Concerning the relationships with other legal entities within the group (parent company, sub-holdings and other subsidiaries), do you generally limit the analyses to a two-way relationships parent company-subsidiary or extend it to the overall network of relationships existing within the group?
- In your experience, have you assigned a rating to a company taking into account data and information of other companies belonging to the group and operating abroad?
- Do you think there are some industries more affected by a greater degree of autonomy or on the contrary by a greater degree of centralization?
- Let us assume that you can access to all the data for both the group level and the single legal entities: what would you use to assess the degree of autonomy of legal entities belonging to a business group?
- In your experience, has the assessment of the board's composition led to any adjustments in assigning a rating?
- In view of the Italian context, do you think that the different kind of ownership (family groups, MNC, State Owned Enterprise) may have an impact on the assessment of the degree of autonomy?
- Do you think that carrying out this type of research in other EU countries would give us similar answers? Or do national contexts determine situations that are definitely not comparable?

APPENDIX 2 – Interviews' Duration

Phase	Company	Role	Type	Total duration (in minutes)
First wave	A	Director of the Corporate Rating Sector	Phone call	24
First wave	B	CEO	Phone call	21
First wave	C	Responsible of the team of rating analysts	Phone call	30
Second wave	A	Director of the Corporate Rating Sector	Face-to-face	58
Second wave	B	Responsible for rating activities	Face-to-face	74
Second wave	C	Responsible of the team of rating analysts	Face-to-face	55

Source: author's elaboration