Executive Summary

Non-financial corporate groups are comprised of several legal entities, each with its own role and purpose. Some are established to serve entirely financial purposes which are legally and organisationally separated from the group's main line of business. This thesis examines the role of these subsidiaries in three industrial sectors, namely the automotive, utilities as well as the chemicals and pharmaceuticals industry.

It was not possible to gather balance sheet data of subsidiaries in a satisfactory way, therefore only debt data from 43 corporate groups have been downloaded as these were readily available in Bloomberg's database. A group was added to the sample if they had at least one bond that appeared on the list of eligible assets for the Eurosystem, which was provided by the supervisors. The sample contains around 882 billion Euro worth of debt, with almost half that was issued by two distinct types of financial subsidiaries. One of these, which appears in all three sectors, is a type of company which raises funds on the capital markets to grant these as loans to other members of the group. In this thesis, these are called Internal Finance companies for lack of a uniformly established name in the literature. By granting loans to affiliates in countries with higher tax rates, the group's overall tax expenses can be minimised as some of the affiliate's profits are shifted to a lower tax environment in the form of interest payments. It is therefore not surprising that the Internal Finance companies in the sample are mostly incorporated in the United Kingdom or the Netherlands, which both have relatively low corporate tax rates for European standards. Subsidiaries in countries with poorly developed capital markets can get funding from these internal sources as local options are either scarce or more expensive. Bond emissions from Internal Finance companies are mostly guaranteed by the ultimate parent, presumably because they are highly leveraged and investors would otherwise not be willing to invest or require higher interest.

The second type of financial subsidiary in the sample are Captive Financials, which only appear within the automotive industry. Their purpose is to provide customers of products produced within their group with financial solutions such as loans, leasing or insurance. Other than the Internal Finance subsidiary, they are incorporated in the country of their customer base. Studies have shown that Captives have lower credit standards than other companies specialised in this field, i.e. they

also grant loans or leases to customers who would otherwise not receive such from other financial intermediaries. Potential losses from defaults are cross-subsidised by increased sales. Each of the four car producers in the sample also has at least one Captive subsidiary with a banking licence to offer a wider range of financial services, such as customer deposits.

The credit ratings of the bonds issued by these two types of financial subsidiaries are analysed. For each bond, information about the asset rating and the ratings for the issuing and guaranteeing company were gathered from four ratings agencies, namely Moody's, Fitch, Standard & Poor's and DBRS. The ratings from any single agency are extremely uniform, the asset ratings most often coincides with the one assigned to the issuer or the guarantor. Slightly more than 20% of the bonds issued by financial subsidiaries in the sample did not receive an asset rating. Using a Logit model, it is shown that smaller issuances from Internal Finance companies, which have a relatively strong issuer or guarantor rating assigned, are less likely to be rated themselves.