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The Demise of Bank-Centered Economy and Increasing Roles of Credit Ratings in Japan

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Abstract

After the burst of the bubble economy, Japanese economy has been changed drastically. Traditionally, Japanese economy was characterized as a bank-centered economy, but the banking system did not function well in the 1990's. Responding to banking problems, the Japanese government initiated the Financial Big Bang in 1996 to strength the capability of capital markets. Also, accounting and disclosure rules have been revised to make more credible and wider information available to market participants. If other things be constant, more extensive and timely disclosure should result in more accurate evaluation of firm's risks. However, there is a lack of research that investigates how effective current disclosure is in evaluating corporate risks. This lack of research is mainly because there are not appropriate data sets and methodology to be used for empirical tests. Fortunately, Morgan (2002) proposed a very useful method. That is, he used the disagreement between credit rating companies (i.e., Moody's and Standard and Poor's) over new issued bonds to measure the difficulty in evaluating firms' risks. In this paper, we follow Morgan (2002) and investigate whether credit rating companies likely agreed on the evaluation on Japanese firms' risks after the financial and accounting Big Bang. If there are still large disagreements among credit rating companies, this fact suggests that the current disclosure is not enough for outsiders to evaluate firms, or that there is an inherent limitation of disclosure usage. Also, we are interested in what sectors credit rating companies more often disagree on. Contrary to Morgan (2002), which pointed out that financial industries, such as banks and insurance companies, are difficult to evaluate, we failed to find that disagreements among credit rating companies over banks and insurance companies are larger than disagreements over other industries. However, consistent with Morgan (2002), we found that public utilities industry is easy to evaluate.

This paper is organized as follows. In Section 2, we discuss the current Japanese economic situation and explain the accounting and disclosure reform. In Section 3, we explain data and methodology that are used in this paper. In Section 4, empirical results are provided. Section 5 concludes this paper.

Keywords: Credit ratings, Japanese finance, Credit raters, Bank

JEL Classification: G10, G21

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