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Are credit ratings valuable information?

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Abstract

Credit ratings are commonly used by lenders to assess the default risk, because every credit is connected with a possible loss. If the probability of a default is above a certain threshold, a credit will not be provided. The purpose of this study is to test whether credit ratings contribute valuable information on the creditworthiness of firms. Employing a large sample of Western German manufacturing firms, we investigate loan defaults. First, we estimate Probit models with publicly available information. Subsequently, we additionally use a credit rating and show that it contributes significant information. Our results show that credit ratings have an independent interest in assessing the creditworthiness of firms in case of default.

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Notes

¹ The special issue of the Journal of Banking and Finance, Vol. 25, pp. 1–270 (January 2001), deals with the new Basle Capital Accord in more detail.

² See the special issue of the Journal of Banking and Finance, Vol. 29, pp. 2565–867 (November 2004), for recent research on credit rating, in particular Altman and Rijken (2004) and Löffler (2004).

³ Including operating costs for a bank or any other institution does not alter this result as long as the costs are a ratio of the credit or of the interest rate multiplied with the credit.

⁴ For example, see discussions on the paradigms of the ‘liability of newness’ and the ‘liability of adolescence’ (cf. Singh et al ., 1986 or Brüderl and Schüssler, 1990). Another frequently discussed factor for survival is entry size (see Agarwal and Audretsch, 2001, for a recent study).

⁵ Cf. for an empirical study on the effects of limited liability for growth and survival Harhoff et al . (1998).

⁶ Actually, the ifo Konjunkturindex is published quarterly, but we use only the one from December in period t covering the first half of the year $t+1$.

⁷ Excluding Berlin. Smaller states were merged to one dummy: Bremen with Hamburg and Saarland.

⁸ The McLeod index is a measure of the degree of concentration in the industry, being the ratio of the square of the sum of the market shares of the n firms to the square of n . InL a

⁹ The Vertriebsintensität is defined as the ratio of sales to the number of observations.

¹⁰ Accord

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