



# Explaining credit rating differences between Japanese and U.S. agencies

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## Abstract

We compare credit ratings assigned to Japanese firms by the two leading U.S. rating agencies and the two leading Japanese agencies. Our goal is to investigate the complaint that the U.S. agencies Moody's and Standard and Poor's (S&P) ignore special corporate governance features of Japanese firms, i.e., *keiretsu* affiliation. We find that it is true that ratings of Japanese firms by the U.S. agencies are systematically lower than those assigned by Japanese raters. However, the reasons for the differences are not found to be related to *keiretsu* affiliation. Thus, we reject one of the prominent reasons for rating differences put forth by managers of Japanese firms. This leaves open the question of what drives the difference. The phenomenon is clearly consistent with more general home bias documented in previous work.

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## 1. Introduction

We examine credit ratings assigned to Japanese firms by Japanese and U.S. rating agencies. The highly publicized claim that split ratings are pervasive between U.S. and

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Japanese raters is clearly supported. Managers of Japanese firms assert that the differences may be attributed to insufficient appreciation of the realities of Japanese corporate governance by U.S. agencies, hence the problem arises due to differences in rating criteria. On the other hand, differences may arise because U.S. firms apply tougher standards across the board to Japanese firms without regard to corporate governance mechanisms peculiar to Japan. Of course, this same phenomenon could be said to be due to *Japanese* raters applying *weaker* standards to Japanese firms, i.e., a home bias.

A preview of our findings is shown in Fig. 1. The four frequency distributions represent credit ratings ranging from CCC to AAA for a sample of 92 Japanese firms. The top two panels reflect ratings assigned in March 2000 by the two most prominent Japanese agencies: Rating and Investment Information (R&I) and Japan Credit Rating Agency (JCR). The contrast with the bottom two panels is pronounced. These distributions are for the same 92 Japanese firms, rated by the two largest U.S. agencies in March 2000: Standard and Poor’s (S&P) and Moody’s. Clearly, the U.S. agencies rate Japanese firms lower relative to Japanese agencies.

We find that split ratings between U.S. and Japanese agencies are systematic, i.e., the two major Japanese agencies, JCR and R&I, routinely assign higher ratings to Japanese firms than those assigned by Moody’s and S&P, and they seldom assign lower ratings. The ratings by Japanese agencies have very high rank correlation with those of U.S. agencies, i.e., assessments of *relative* default risk are quite similar. Moreover, the systematic differences apply to nonfinancial as well as financial firms.

The systematic nature of the differences could easily be taken as support for the charge that U.S. agencies ignore or at least underweight the special nature of Japanese governance. We

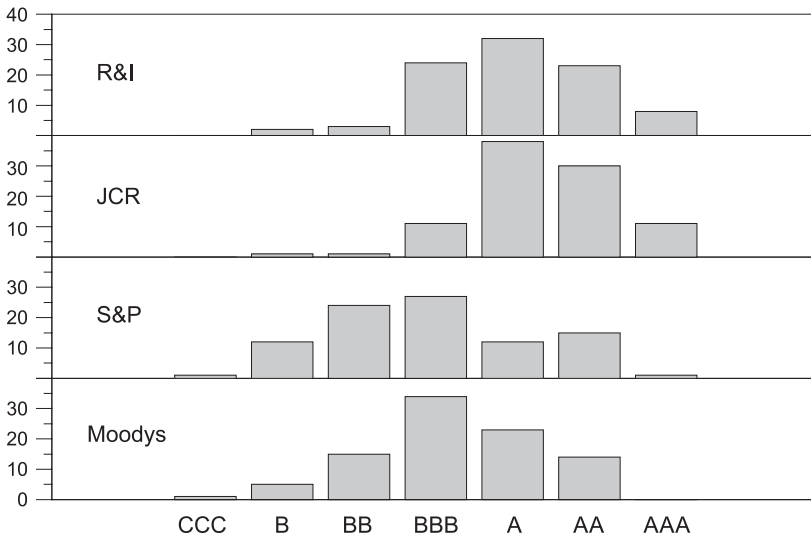


Fig. 1. Frequency distribution of ratings assigned to 92 Japanese Firms by Moody’s, S&P, JCR, and R&I. The category CCC included ratings at or below this level. The rating labels correspond to S&P, JCR, and R&C. Respective Moody’s ratings are Caa, B, Ba, Baa, A, Aa, and Aaa.

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