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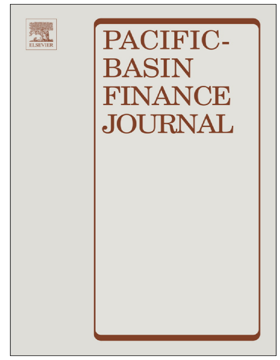

Japanese corporate leverage during the Lost Decades

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Japanese Corporate Leverage during the Lost Decades

Joye Khoo[*] and Robert B. Durand

Abstract

Japan's Lost Decades **(失われた20年)** present a unique opportunity to study firm behavior during a period of prolonged economic distress. This paper demonstrates that lessons learnt in "normal" conditions apply to firms in economies *in extremis*. Japanese firms relied on internally generated funds and precautionary cash holdings to reduce their debt. We document considerable growth in *nearly-all-equity* firms: 7.5% in 1990 to 28.3% in 2014. We also document that Japan's Lost Decades are associated with firms having low market-to-book ratios. Firms' leverage is lower, however, only when market-to-book values are unequivocally high.

Highlights

- We analyse the determinants of firms' leverage during Japan's Lost Decades.
- Japanese firms raised equity when valuations were unambiguously generous.
- Firms reduced debt using internally generated funds and precautionary cash.
- *Nearly-all-equity* firms increased from 7.5% in 1990 to 28.3% in 2014.
- Evidence from firms in normal economies applies in economies *in extremis*.

JEL classification: G30, G32, G34

Keywords: Capital structure, all equity firms, Japan's lost decades

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