THE INTERRELATIONSHIPS BETWEEN RATING AGENCIES, BANKS AND INVESTORS

A THESIS PRESENTED IN FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE OF DOCTOR OF PHILOSOPHY IN FINANCE AT MASSEY UNIVERSITY

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Abstract

Bank loan ratings are employed to investigate the interrelationship between the rating agencies and banks. Valuation effects of rating announcements on investors in the market are also examined. Similar functions are performed by rating agencies and banks, however, it is found that investors perceive information provided by rating agencies and banks differently. In the first essay, the results indicate that investors recognise the value of rating agencies in the presence of banks as information providers and monitors. The value of rating agencies relies on their recognition of deteriorating prospects in a firm’s financial position, as the market reacts significantly to bank loan rating announcements of placement on CreditWatch with negative implications and downgrades. In the second essay, the results indicate that investors recognise the value of high quality banks in the presence of rating agencies as information providers and monitors. When the deteriorated firms are associated with high quality banks, the negative reaction toward announcements of negative placement and downgrade is mitigated. This indicates that investors are willing to trust high quality banks’ speciality in information and monitoring, and reassess the value of deteriorated firms. In the third essay, the results show that the value of rating agencies; via announcements of negative placement and downgrade; also expands to non-rated firms smaller than the rated firms, in the same industry. Announcements of negative placement indicate firm-specific deterioration and, therefore, smaller rival firms benefit from the change in competitive balance. From the announcements of downgrade, however, smaller rival firms experience contagion effect.
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