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InkLocal credit rating agencies: a new dataset

Ginevra Marandola *

University of Bologna, Department of economics, Piazza Scaravilli 2, 40126 Bologna, Italy

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ABSTRACT

Local credit rating agencies are an important phenomenon both in emerging and high income economies. There are over 200 local agencies around the world, which provide ratings for small domestic issuers and their securities. This work presents the first comprehensive collection of information and data on local agencies' global presence, and on Moody's, S&P and Fitch's offices and affiliates around the world. The dataset includes agencies operating in over 60 countries between 1970 and 2012, providing the date of incorporation of the agencies and information about mergers and acquisitions. The paper also discusses and shows empirical evidence on the determinants of the presence of local agencies and global agencies' branches. Local credit rating agencies are particularly widespread in Asia and Latin America, where governments have promoted their activity. On the other hand global agencies often enter the market by acquiring local agencies or starting joint ventures with them.

1. Introduction

The credit rating business started at the beginning of the 20th century in the United States during the construction of the rail system. The first agencies to provide rating services were Moody's and S&P that now dominate the market internationally. Ratings have been a U.S. phenomenon for more than 70 years until the 80's when financial markets started to develop in other countries and to become increasingly international. In this period the need of common credit quality standards and the well-known reputation of the agencies enabled them to extend their business in almost every part of the world. Nowadays Moody's, S&P and Fitch (big three) are the major players in the credit rating business, holding more than 94% of the global market share and having offices in 46 countries. Still, domestic debt in local currency and small enterprises' issues, especially in emerging countries, are not covered by the big three. These securities instead receive ratings by the over 200 local credit rating agencies (CRAs) operating in more than 60 countries.

Local CRAs are a widespread phenomenon in developing and developed countries but they are largely overlooked by the economic literature. This work fills the gap.[1] In the first part sparse anecdotal evidence on local CRAs' history and global expansion is collected and organized in order to provide an organic review on the geography of local credit rating agencies. Then a new database on local CRAs' penetration around the world is presented.[2] This is the first systematic and comprehensive collection of information and data on local CRAs. The dataset includes more than 200 local credit rating

* Corresponding author.
E-mail address: ginevra.marandola@gmail.com

[1] Among the few works on this topic: Ferri and Lacitignola (2007) on the effect of local CRAs' presence on financial markets; the Bank of International Settlement Report of 2000 on regional credit rating agencies; Park and Rhee (2006) on credit rating agencies in Asia.

[2] The database is available at the following link: https://www.dropbox.com/s/t7n7tmn4xzrst76/dataset.xlsx?dl=0

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agencies (CRAs) in 61 countries, for each agency it provides the date of incorporation and the date of death and information on mergers and acquisitions between local agencies or with one of the big three. The main purpose of the paper is to trigger scholars' attention on local credit agencies as well as to provide a dataset on which further studies can be built.[3] Moreover, some descriptive and multivariate analysis is performed in order to identify the main determinants of the agencies' appearance and diffusion.

The study distinguishes between global agencies' offices/affiliates and independent local CRAs and involves cross-country and panel data analysis. The empirical evidence suggests that legal origin does not matter for the birth of local agencies while it significantly affects the opening of global agencies' offices and affiliates. Indeed, big three's branches are more diffused in English origin countries. This in line with La Porta et al. (1997, 1998) that show that English origin countries have deeper financial markets and better institutions. Local agencies and big three affiliates are more likely to appear in Buddhist countries. Although surprising the result is perfectly in accordance with the observation that local agencies are widely diffused in Asia where they collaborate through the Asian Credit Rating Agencies Association (ACRAA).

Often local CRAs are the result of government intervention. Financial authorities create the condition for the business directly through regulatory provisions that mandate the use of ratings for certain financial activities or through the general improvement of the financial environment that makes the rating business more profitable. The first big three affiliate (office) often follows the first local agency, both because by definition an affiliation can occur if the local agency already operates in the country and because countries where a local agency already operates guarantee some internal demand for ratings. The global agencies generally start operations where securities' markets are already settled and where regulation favors their presence.

Section 2 provides some background on the topic, focusing on the industry, the regulation, the geographical expansion and the economic role of CRAs. Section 3 presents the new database on CRAs' penetration around the world. Section 4 presents empirical results on the determinants of big three's offices and local CRAs' penetration. Section 5 concludes.

2. Background

2.1. Credit rating agencies' global expansion

CRAs were born in the United States at the beginning of the 20th century, railroad industry bonds were the first to obtain a rating. The construction of the railroad system gave local investors the opportunity to start to finance projects in remote regions, for which they needed hard information since they did not have direct knowledge of the borrowers (Sylla, 2002). The credit rating business grew enormously in the following years, and by the mid 90's the most of the issued bonds had a rating. The industry is an oligopoly dominated by Moody's, Standard and Poor's (the pioneers) and Fitch, all established in the United States, whose market share is more than 94% of the global market. For many years credit rating agencies have been a U.S. phenomenon but during the 70's as the number of international investors increased, the need of international creditworthiness standards became greater in many countries. Since then, Moody's, S&P and Fitch have increased their global presence, establishing branches in more than 40 countries around the world. The big three's global penetration also served the agencies' objective to enter new markets especially in developing countries. However, adapting rating standards to peculiar countries' characteristics implies significant costs for the big three because it requires specific knowledge of the local market, human resources and data collection. Therefore, in order to enlarge their business more efficiently, Moody's, S&P and Fitch have established collaborations and joint ventures with local credit rating agencies. These include agencies in Korea, China, India, Chile, Argentina, Philippines, India, Peru, Venezuela and Russia. Joint ventures were typical also in European countries where the local agencies were a takeover target when they provided ratings not only for the internal market but also for foreign investors.[4]

Although Moody's, S&P and Fitch have become global, the number of local currency denominated bonds being rated by them is limited and the rating standards of the agencies do not always satisfy local issuers.[5] Park and Rhee (2006) claim that the standards and methodology adopted by the big three are mainly designed for developed countries and therefore they are not suitable for local bonds in developing countries. Ferri et al. (1999) argue that companies in developing countries are more conservatively rated than companies in developed countries, thus issuers complain about unjustified low credit ratings arguing that global rating agencies should introduce a new system for their markets. Even developed countries, such as Japan, argue that the big three's rating system only suits the American financial and economic model. According to Japanese managers and financial institutions this leads to lower ratings for their issues. Shin and Moore (2003) report that, according to a survey conducted in 1999 by The Japan Center for International Finance (JCIF) on the role of the big three, 90% of the interviewed (175 financial institutions and 89 industrial firms) thought that the rating standards of Moody's and S&P do not appropriately take into account specific Japanese factors in areas like corporate governance. On the other hand,

[3] For example, in a companion paper the data are used to assess the impact of local agencies' activity on bond markets.

[4] Héritier (2002), p. 305)

[5] Since ratings to private debt often have sovereign ratings as upper bound, "the distinction between local currency ratings and foreign currency ratings is important given that sovereign governments default more frequently on foreign currency debt than on local currency debt. In each of the last 25 years, sovereign foreign currency default rates have exceeded sovereign local currency default rates by at least three times." (Bissoondoyal-Bheenick, 2012, p. 81)