

CHAPTER V

Conclusion and Recommendation

5.1 Conclusion

This study provides empirical evidence on the behavior of issuer ratings change in G7 except US by employing static and hazard rate techniques and comparing the performances of both techniques. This study also investigates that whether standard of S&P are lenient when assigning ratings.

The empirical results on a comparison of static and hazard forecasting performances show that hazard rate models provide a bit better performances in predicting ratings change than static models in the out-of-sample forecasts. By demonstrating the correspondence of the area under the ROC curve of both models, hazard rate models provide a bit larger areas than static model. Even though hazard rate models perform a bit better than static models, these results are consist with the theory that hazard rate model is more appropriate than static model in forecasting. Shumway (2001) provides three theoretical reasons to prefer hazard rate model. The first reason is hazard rate model resolves the problems of static model by explicitly accounting for time. The dependent variable in hazard rate model is the time spent by a firm in each rating class while static model just simply considers only before rating is changed. The second reason to prefer hazard rate model is that it incorporates time-varying covariates or explanatory variables that change with time. It exploits each firm's time series data by including annual observations as time-varying covariates. The third reason that hazard rate model is preferable is that it may produce more efficient out-of-sample forecasts by utilizing much more data. Additionally, this study examines the difference between these two models by measuring the difference of the areas below ROC curves of static and hazard rate models. The results are inconclusive

in this test. They are based on the set of explanatory variables which study uses. Therefore, it cannot conclude that static are certainly different from hazard rate model.

Moreover, there were distress failures of great companies even though they had investment rates leading some to conclude that these collapses occurred because of accounting fraud and corruption. However, alternative explanation of these failures is that the rating agencies are now using softer standards in assigning ratings. This study examines standard of S&P agency by employing ordered logit technique and using five sets of explanatory variables including economic factors, the results show that the coefficient of time dummies increase, respectively. The increasing trend in time dummies of five models can be interpreted as the S&P standards are lenient. The robustness tests on investment ratings and US data also indicate that the S&P agency applies softer standard when assigning ratings. Therefore, the failure of great firms in the past can be partly explained by the softer standard of rating agency.

5.2 Recommendation

The sample used in this study is a set of listed and rated firms by S&P in each stock exchange at the end of June 2007, so these firms might be new listed firms which do not exist at the beginning of the period of study. This causes the study has a small amount of observations. The suggestion on this problem is to include more observations by using all listed firm in the period of study. This problem also leads to a limitation on measuring standard of rating agency because small amount of observation in year 1997 through 1999 cannot be used to examine the standard of agency. Therefore, if the longer the length of period of study, the clearer and better results. Moreover, future research can change a group of explanatory variables, for instance, they cannot only be accounting variables but also be other variables that

effect rating prediction like probability of default, investors' perspective, and CFOs' opinions. Additionally, this study examines ratings in developed countries by using well know agency S&P, future research can study rating in emerging countries or using local rating agency instead.