Firm's Internal Dynamics and Credit Risk in Emerging Asia

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Summary

- Paper studies determinants of idiosyncratic credit risk in emerging Asian countries
  - Model-based, time-varying credit risk measure
  - 540 listed firms in 6 countries: 90 firms per country (30-30-30 by credit rating)
- Determinants of credit risk
  - Solvency, operating efficiency, expansion capacity, profitability, size, leverage, volat.
  - 4 core idiosyncratic factors: 2 short-term, 2 long-term

Main Findings

- Default risk increases for lower credit ratings, varies within categories
- Default risk:
  - Driven by small size, high leverage for low-grade firms
  - Driven by high solvency, low leverage for medium- and high-grade firms
  - Decreases when operating efficiency is higher

Comments Overview

- Credit ratings and credit risk measure
- Data sources and construction of dataset
- Model specification and interpretation of results
- Simultaneity

Credit Ratings and Credit Risk Measure

- Credit ratings used to separate firms into categories
  - What if credit rating of a firm changes during sample period?
- Model-based credit risk measure already ‘incorporates’ accounting information
  - Relationship with market-based ‘model-free’ measures?
  - Heterogeneity test does not discard existence of a common component

Data Sources and Construction of Dataset

- Are variables standardized across countries?
- More clarity on rationale for short-term and long-term factors
  - Leverage ratio also captures solvency of a firm but excluded from factor
  - Why principal components?
- Characteristics of firms in the sample?
  - Business profile: Size, industry, market (exporters/importers), etc.
  - **Debt** profile: currency (local/foreign), maturity (short -, medium-, long-term)

Model Specification and Interpretation of Results

- Baseline case: Model run per country, per credit rating category
- Considerations:
  - Binary variable for credit rating categories
  - Country fixed effects instead of firm fixed effects, and consistent sample size
  - Interaction terms
  - Do standard errors reflect data properties?
- Interpretation of 4 core idiosyncratic factors (e.g. units)?

Simultaneity

- Quarterly frequency
- Direction of relationship is not clear
  - Decisions by firm managers affect firm's credit risk
  - Firm's credit risk affects its borrowing costs and so decisions by firm managers

Conclusion

- Important topic, intuitive results
- Determinants of idiosyncratic credit risk
- Main comments:
  - Credit risk measure
  - Characteristics of firms included, especially their debt profile
  - Model specification and identification