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Master Thesis

Do the major rating agencies influence the share price of a company?

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Handed in: 19.12.2017

Abstract

This thesis aims to assess whether the big three rating agencies (Fitch, Moody's and S&P) have sway over the share price. This is achieved by hand collecting a large sample of rating change events and running a regression of the event window return of the company on the beta adjusted market return and an upgrade dummy. Year- and industry-fixed effects are added as robustness tests. It is found that while the upgrade dummy is often significant for the pre-event window, it is mostly insignificant for the post-event period. However in the short run statistically significant effects can also occur in the post event period. This suggests that the decisions of the rating agencies, though driven by past information, may influence the share price of a company after the rating change event. A difference in differences regression is conducted and it is found that there is a mean reversion process in the longer run.

A model is proposed to find out which scheme of payment for the rating would be optimal. The model uses the size of a firm as the primary explanatory variable to assess and compare the costs of information acquisition for the rating agency and the investor. It then turns out that, according to this model, it would be optimal to have an investor paid rating for small firms whereas for large firms an issuer paid rating scheme would be the optimal solution.

The model's assertion that size matters is tested by splitting the collected sample into quartiles. It is shown that large firms indeed react less negative to downgrades and less positive to upgrades, providing support to the model's claim that size matters.