The Effect of Bank Relationships and Ownership Structure on Financing Choices: Evidence from Japan

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Information Production by some agents and disclosure by firms are expected to reduce capital cost. This paper examines the effect of various information producing activities on financing choice. We consider three types of information producer which are strongly related to firms, analysts, banks and firms themselves. We posit four hypotheses: the information asymmetry problem on market choice, the pecking order theory, the effect of reputation of relationships with banks, and the hold-up problem by bank. As the precision of analysts' and firms' information, we employ the standardized surprise of earnings forecasts. We use the long-term bank relationships variable as the proxy of good creditability. To gauge the effect of these variables on financing choice, we employ two nested logit models, security-market model and market-security model. Our main findings suggest empirical evidence supporting hypotheses related to the information asymmetry problem on market choice, the pecking order theory, and the hold-up problem. The lower precision of analysts and/or firms information leads to choice of private issuance, which is stronger in the case of equity. In public markets firms with severe information asymmetry choose issuing debt, while firms with severe information asymmetry choose issuing equity in private markets. These results imply the complement role of analysts' information and firms' disclosure in mitigating the information problems which stock market investors face. We cannot obtain the result consistent with the reputation hypothesis, but the hold-up problem has strong effect on market choice in debt financing. Firms are likely to choose private bond when they have a longterm relationship with a main bank. We also find that the hold-up problem is mitigated as dependence on bank loans gets lower. There are some implications other than our hypotheses. It seems that the market timing and the agency problem affects financing choice.